PD-ABI-214
87414

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

# PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number
660-T-604 (660-0120)

2. Country
Zaire

3. Category
Zaire Private Sector Support Program

4. Date
April, 1989

5. To
Walter Bollinger
Assistant Administrator, Africa Bureau

6. OYB Change Number

7. From
Dennis Chandler
Director, USAID/Kinshasa

8. OYB Increase

To be taken from:

9. Approval Requested for Commitment of
$14,000,000

10. Appropriation Budget Plan Code 72 1191014
Development Fund for Africa
GSSA 89 31660 KG 32 (914 61 660 00 59 91

11. Type Funding
☐ Loan ☒ Grant

12. Local Currency Arrangement
☐ Informal ☒ Formal ☐ None

13. Estimated Delivery Period
4/89 - 6/91

14. Transaction Eligibility Date
Date of Grant Agreement

15. Commodities Financed
Only commodities eligible for AID financing and capable of supporting the agricultural, industrial, or manufacturing sectors in Zaire shall be financed by this Grant.

| 16. Permitted Source | | 17. Estimated Source | |
|---|---|---|---|
| U.S. only | | U.S. | $7,000,000 |
| Limited F.W. | | Industrialized Countries | |
| Free World | $14,000,000 (Code 935) | Local | |
| Cash | | Other | $7,000,000 Selected Free World |

18. Summary Description
The attached PAAD contains justification for a $35,000,000 non-project assistance grant to be administered through a Commodity Import Program (CIP) to restructure the Zairian commercial banking sector to support productive investment by medium and smaller-scale enterprises (MSEs). This facesheet approves a $14,000,000 non-project assistance grant for this purpose.

The PAAD facesheet authorizes only $14,000,000 which is the dollar amount planned for obligation in FY 89 as the initial tranche of non-project assistance disbursement to be provided under the program. In each subsequent fiscal year of the program, the PAAD facesheet may be amended by the USAID Kinshasa Director to increase the authorized level of funding by the amount to be obligated during the respective year.

BEST AVAILABLE DOCUMENT

Clearances:

AFR/CONT:RKing 5/19/89
for M/SER/OP/COMS/O:JWarner 5/18/89
PPC/PB:RMaushammer 5/18/89

| 19. Clearances | Date |
|---|---|
| DAA/AFR:ELSaiers | 5/22/89 |
| DAA/AFR:WBollinger | |
| GC/AFR:JKnott | 5/22/89 |
| AFR/DP:JWestley | 5/17/89 |
| AFR/PD:TBork | 5/22/89 |
| AFR/CCWA:JColes | 5/17/89 |
| M/FM:EOwens | 5/19/89 |

20. Action

☐ APPROVED ☐ DISAPPROVED

Authorized Signature

Date

Title

AID 1120-1 (5-82)

CLASSIFICATION:

Pursuant to the Foreign Assistance Act of 1961, as amended, and the Foreign Operations, Export Financing and Related Programs Appropriations Act of 1989, I hereby approve the five year non-project assistance component described herein. I hereby delegate authority to the Director, USAID/Kinshasa to authorize these incremental non-project assistance funds. Conditionality in these PAAD amendments must be consistent with the program purpose and conceptual framework now included in the PAAD.

The Grant Agreement will contain the following essential terms and conditions for disbursement.

a. Prior to signature of the Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., evidence that it has taken the following actions:

- Reduced the gap between the official and parallel exchange rates, particularly through devaluation of the officical exchange rates;

- Reduced the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revised the Government of Zaire's (GOZ) tax collection procedures including custom taxes, tax administration, and increased fuel taxes.

b. Condition Precedent to First Disbursement. Prior to any disbursement, or the issuance of any commitment documents pursuant to which disbursement will be made, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., a statement of the names and titles of persons who will be official and additional representatives of the Cooperating Country under the Program Agreement, together with a specimen signature of each person specified in such statement.

c. Condition Precedent to First Disbursement for Commercial Bank Financing of Private Enterprises. Prior to any disbursement under the Program Agreement, or the issuance of any commitment documents pursuant to which disbursement will be made, to provide funding for commercial bank financing of private enterprises, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

(1) A written comprehensive statement of policy governing the development of the financial sector of Zaire ("Financial Sector Development Policy Statement"). The statement shall embody a liberal, private sector-oriented approach to financial sector reform and development and shall include, but not be limited to, objectives to promote commercial bank mobilization of private domestic financial resources; to foster a more active money market and interest rates representative of the real economic cost of funds; and to increase the amount of credit available to private enterprises. The statement will include specifically the following objectives for the financial sector under this program:



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(a) By the end of the five year program, real financial resources mobilized by private commercial banks should be growing by at least 4 percent per year.

(b) Interest rates should be positive relative to inflation.

(c) Commercial banks should be financing a wider range of enterprises than before the program in terms of size, sector of activity, and geographic area.

(d) Most of the budget deficit of the GOZ should be financed from the market at market determinded rates.

(e) No GOZ constraints should remain on bank interest rates or fee structures.

(f) Required reserves should be set at minimum levels necessary for stability and efficient growth of the banking system.

(g) Most of the required reserves should be held in the form of treasury bonds remunerated at market rates of interest. Required reserves deposited at the Bank of Zaire also should be remunerated at market rates of interest subject to the conclusions of a study by the parties to this agreement.

(h) The Central Bank should be acting only as lender of last resort and should charge market-based interest rates.

(i) The GOZ should be moving to replace administrative credit ceilings (direct controls with indirect controls on credit that are automatically linked to mobilization of resources by the banking system).

(2) A list of persons and agencies designated to meet and consult with A.I.D. at six-month intervals, beginning no later than six months after the signing of the Program Agreement, in order to monitor compliance with the various conditions and covenants for the Program Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the program, and review the results of program activities.

d. <u>Conditions Precedent to Second Disbursement for Commercial Bank Financing of Private Enterprises.</u> Prior to the second disbursement under the Program Agreement, or the issuance of any commitment documents pursuant to which disbursement will be made, to provide funding for commercial bank financing of private enterprises, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence that as discussed in the regular six-month AID/GOZ Consultations, the GOZ has taken specific steps and made substantial progress in:

(1) reducing commercial bank reserve requirements to minimum levels necessary for stability of the banking system;

(2) removing remaining constraints on bank interest rates or fee structures;

(3) reducing the gap between the rate of inflation and

the Bank of Zaire money market rate;

(4) reducing total commercial bank obligations to the Bank of Zaire as a proportion of required reserves relative to the level of December 31, 1987 by at least five percentage points.

The first Program Implementation Letter (PIL) will describe the specific degree of progress expected, given conditions at the signing of the Program Grant Agreement.

e. Subsequent Conditions Precedent. Specific conditions precedent will be formulated for disbursement at six month intervals based on the results of the bi-annual AID/GOZ consultations on the implementation of the financial section development program and the GOZ's progress in attaining the objectives of that program.

Prior to disbursements of subsequent tranches of funding for commercial bank financing of MSEs, the GOZ shall:

(a) Take those measures agreed upon with AID during the regular GOZ/AID program consultations to execute financial sector reforms, including measures aimed at attaining the specific objectives identified in the Financial Sector Development Policy Statement for the purpose of:

(1) promoting the mobilization by commercial banks of domestic financial resources and private savings;

(2) fostering a more active money market and interest rates more representative of the real economic cost of funds; and

(3) increasing the amount of credit in real terms available to the private sector.

(b) Demonstrate during the regular GOZ/AID program consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the program.

f. Covenants. The Cooperating Country shall covenant that, unless A.I.D. otherwise agrees in writing, it will:

(1) Meet and consult with A.I.D. at not less than six-month intervals, beginning no later than six months after the signing of the Program Agreement, in order to monitor compliance with the various conditions and covenants of the Program Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the project, review the results of project activities and establish conditions precedent which shall apply to subsequent disbursements under the project. As soon as possible but not later than six months after the signing of the Program Agreement, the Cooperating Country shall agree with A.I.D. on a list of criteria with which to monitor the progress of financial reforms as outlined in the Financial Sector Development Policy Statement or as undertaken as reform measures. These criteria may include but need not be limited to the following:

(a) The real growth of domestic financial resources and private savings held by the banking system;

(b) The reduction in the gap between the Bank of Zaire's lending rates of interest and the inflation rate;

(c) The increase in the real value of credit extended by the banking sector to the private sector; and

(d) A shift from direct to indirect methods of controlling the money supply following successful and sustained macroeconomic stabilization.

(e) The degree to which commercial banks are financing a wider range of enterprises than before the PSSP Program in terms of size, sector of activity, and geographic area.

(2) Take measures to progressively reduce deficits in the annual Government budget and to take other steps to reduce and stabilize the rate of inflation.

(3) Continue a policy of liberalized interest rates.

(4) Maintain a policy of market-based, floating official exchange rates and to ensure that the difference between the official and parallel exchange rates does not exceed twenty percent.

(5) Practice a policy of full-cost fuel pricing.

(6) Maintain a liberal policy concerning foreign trade in commodities, not introduce quotas on imports or exports, and continue the announced program of tariff-rate reform which will progressively moderate effective rates of protection.

(7) Maintain liberalized pricing policies and not introduce administrative controls, ex ante or ex post, on prices of private goods and services.

(8) Not finance with program funds the importation of pesticides.

The local currency counterpart fund generations from the PSSP's dollar commodity import program will be deposited in a special account specifically for the PSSP and will be programmed under normal Mission counterpart fund programming and budgeting policies and procedures. Projected uses of local currency generations are set forth in the body of the PAAD.

Date: 5/24/89 Signature: [signature]

Clearances: As shown on the Action Memorandum

XD-ABJ-44-A

| AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET | 1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) Amendment Number | DOCUMENT CODE 3 |
|---|---|---|
| 2. COUNTRY/ENTITY: Zaire | 3. PROJECT NUMBER: 660-0120 | |
| 4. BUREAU/OFFICE: AFR 06 | 5. PROJECT TITLE (maximum 40 characters): Private Sector Support Program | |

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 94

7. ESTIMATED DATE OF OBLIGATION (Under "B." below, enter 1, 2, 3, or 4): A. Initial FY 89 B. Quarter 2 C. Final FY 91

8. COSTS ($000 OR EQUIVALENT $1 = )

| A. FUNDING SOURCE | FIRST FY B. FX | FIRST FY C. L/C | FIRST FY D. Total | LIFE OF PROJECT E. FX | LIFE OF PROJECT F. L/C | LIFE OF PROJECT G. Total |
|---|---|---|---|---|---|---|
| AID Appropriated Total | 2000 | | 2000 | 5000 | | 5000 |
| (Grant) | (2000) | ( ) | ( ) | ( ) | ( ) | ( ) |
| (Loan) | ( ) | ( ) | ( ) | ( ) | ( ) | ( ) |
| Other U.S. 1. | | | | | | |
| Other U.S. 2. | | | | | | |
| Host Country | | 300 | 300 | | 1500 | 1500 |
| Other Donor(s) | | | | | | |
| TOTALS | 2000 | 300 | 2300 | 5000 | 1500 | 6500 |

9. SCHEDULE OF AID FUNDING ($000)

| | A. APPROPRIATION | B. PRIMARY PURPOSE CODE | C. PRIMARY TECH. CODE 1. Grant | C. PRIMARY TECH. CODE 2. Loan | D. OBLIGATIONS TO DATE 1. Grant | D. OBLIGATIONS TO DATE 2. Loan | E. AMOUNT APPROVED THIS ACTION 1. Grant | E. AMOUNT APPROVED THIS ACTION 2. Loan | F. LIFE OF PROJECT 1. Grant | F. LIFE OF PROJECT 2. Loan |
|---|---|---|---|---|---|---|---|---|---|---|
| (1) | 700 | 840 | | | | | 5000 | | 5000 | |
| (2) | | | | | | | | | | |
| (3) | | | | | | | | | | |
| (4) | | | | | | | | | | |
| TOTALS | | | | | | | 5000 | | 5000 | |

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To restructure the Zairian commercial banking sector to suppor productive investment by medium and smaller-scale enterprises (MSEs)

14. SCHEDULED EVALUATIONS

Interim MM 06 YY 91 MM 09 YY 92 Final MM 07 YY 93

15. SOURCE/ORIGIN OF GOODS AND SERVICES

☐ 000 ☐ 941 ☒ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

| 17. APPROVED BY | Signature | 18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION MM DD YY |
|---|---|---|
| | Title: Director, USAID/Kinshasa — Date Signed MM DD YY | |

AID 1330-4 (8-79)



6X

## INSTRUCTIONS

The approved Project Data Sheet summarizes basic data on the project and must provide reliable data for entry into the Country Program Data Bank (CPDB). As a general rule blocks 1 thru 16 are to be completed by the originating office or bureau. It is the responsibility of the reviewing bureau to assume that whenever the original Project Data Sheet is revised, the Project Data Sheet conforms to the revision.

Block 1 - Enter the appropriate letter code in the box, if a change, indicate the Amendment Number.

Block 2 - Enter the name of the Country, Regional or other Entity.

Block 3 - Enter the Project Number assigned by the field mission or an AID/W bureau.

Block 4 - Enter the sponsoring Bureau/Office Symbol and Code. *(See Handbook 3, Appendix 5A, Table 1, Page 1 for guidance.)*

Block 5 - Enter the Project Title *(stay within brackets; limit to 40 characters).*

Block 6 - Enter the Estimated Project Assistance Completion Date. *(See AIDTO Circular A-24 dated 1/26/78, paragraph C, Page 2.)*

Block 7A. - Enter the FY for the first obligation of AID funds for the project.
Block 7B. - Enter the quarter of FY for the first AID funds obligation.
Block 7C. - Enter the FY for the last AID funds obligations.

Block 8 - Enter the amounts from the 'Summary Cost Estimates' and 'Financial Table' of the Project Data Sheet.
NOTE: The L/C column must show the estimated U.S. dollars to be used for the financing of local costs by AID on the lines corresponding to AID.

Block 9 - Enter the amounts and details from the Project Data Sheet section reflecting the estimated rate of use of AID funds.
Block 9A. - Use the Alpha Code. *(See Handbook 3, Appendix 5A, Table 2, Page 2 for guidance.)*
Blocks 9B., C1. & C2. - See Handbook 3, Appendix 5B for guidance. The total of columns 1 and 2 of F must equal the AID appropriated funds total of 8G.

Blocks 10 and 11 - See Handbook 3, Appendix 5B for guidance.

Block 12 - Enter the codes and amounts attributable to each concern for Life of Project. *(See Handbook 3, Appendix 5B, Attachment C for coding.)*

Block 13 - Enter the Project Purpose as it appears in the approved PID Facesheet, or as modified during the project development and reflected in the Project Data Sheet.

Block 14 - Enter the evaluation(s) scheduled in this section.

Block 15 - Enter the information related to the procurement taken from the appropriate section of the Project Data Sheet.

Block 16 - This block is to be used with requests for the amendment of a project.

Block 17 - This block is to be signed and dated by the Authorizing Official of the originating office. The Project Data Sheet will not be reviewed if this Data Sheet is not signed and dated. Do not initial.

Block 18 - This date is to be provided by the office or bureau responsible for the processing of the document covered by this Data Sheet.

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PRIVATE ENTERPRISE SUPPORT PROGRAM

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Timothy J. Bork

Subject: Zaire: Private Sector Support Program (PSSP) 660-0120

I. Problem: You are requested to approve a grant for $40.0 million from the Development Fund for Africa Account for the Zaire Private Sector Support Program.

II. Discussion: USAID/Zaire proposes to provide $40 million to restructure the Zairian commercial banking sector and enable it to support productive investment by medium and smaller-scale enterprises (MSEs). Of the $40 million, $35 million will be provided in non-project assistance under a CIP, and $5 million will be provided for technical assistance, studies, and evaluations.

The PSSP will help reverse the decline in industrial production and re-establish demand and supply linkages between urban and rural areas. Medium and smaller enterprises (MSEs) receiving financing from commercial banks will increase their production, capacity utilization, and profitability. The ultimate beneficiaries of the program are the workers in private enterprise borrowers, consumers, and smaller urban and rural producers. These beneficiaries will receive, respectively, increased employment and income, wider distribution of basic consumer goods at lower prices, and improved markets for the agricultural and other products they produce.

Through technical assistance and studies combined with policy conditionality, the program will facilitate restructuring and reform of the commercial banking sector to support more productive investment by MSEs. As these financial sector reforms are taking effect, $35 million in foreign exchange financing under a CIP mechanism and $13.5 million in local currency lending will enable medium and smaller-scale enterprises in Zaire to purchase needed raw materials, spare parts, and replacement equipment and thus increase utilization idle plant capacity. Local currency financing will encourage MSEs to utilize more local products such as jute for making agricultural sacks and palm oil for soap production. Commercial bank financing of MSEs will occur at market rates of interest.

The Zairian economy is in a recession characterized by high inflation, foreign exchange shortages, and decreasing production of manufactured goods. Rejuvenation of Zaire's manufacturing industries is essential to Zaire's economic recovery. In addition to using and processing local products, local industries also produce and distribute basic consumer goods throughout the country.

To recover and expand, the Zairian private sector requires an effective commercial banking sector. Financial sector reforms under the PSSP will result in increased credit to private enterprises through two means. First, through monetary policy changes such as reduced reserve requirements and remuneration of reserves, commercial banks will enjoy an improved incentive framework for mobilization of private savings. Second, because of experience during the program with MSE lending and because of a growing level of domestic financial resource mobilization, participating banks will begin to provide term credit to a wider range of enterprises as defined by size, sector of activity, and geographic location.

Repayments of principal and interest will be deposited in a special separate account for this program as requested by Section 609 of the Foreign Assistance Act of 1961, as amended. By fixing the exchange rate determining the local currency value of loans at the point of the opening of the letter of credit, the program will assume the foreign exchange risk. Participating banks will assume the commercial risk and will be debited for repayments and interest regardless of whether their borrowers repay.

Financial Plan: For the overall program, the Mission plans to obligate $16,000,000 in the second quarter of FY 1989, $16,000,000 in FY 1990, $7,000,000 in FY 1991, and $1,000,000 in FY 92.

AID and GOZ contributions by major category are as follows:

| | AID $000's | GOZ $000's* | TOTAL |
|---|---|---|---|
| Private Sector Financing | $35,000 | $13,500 | $48,500 |
| Program Management | 3,400 | 500 | 3,900 |
| Studies and Short-Term Tech. Asst. | 950 | 500 | 1,450 |
| Fiduciary Bank, Audits and Evaluation | 650 | 500 | 1,150 |
| TOTAL | $40,000 | $15,000 | $55,000 |

*local currency equivalent

## III. Conditionality

Prior Actions

Prior to signature of the Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., evidence that it has taken the following actions:

- Reduced the gap between the official and parallel exchange rates, particularly through devaluation of the officical exchange rates;

- Reduced the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revised the Government of Zaire's (GOZ) tax collection procedures including custom taxes, tax administration, and increased fuel taxes.

Covenants. The GOZ will agree to the following covenants relating (1) to the AID/GOZ policy dialogue process to be established and (2) to the need for macroeconomic stabilization.

(1) Meet and consult with AID at not less than six-month intervals, beginning no later than six months after the signing of the Program Agreement, in order to monitor compliance with the various conditions and covenants of the Program Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the program, review the results of program activities and establish conditions precedent which shall apply to subsequent disbursements under the program. As soon as possible but not later than six months after the signing of the Program Agreement, the Cooperating Country shall agree with AID on a list of criteria with which to monitor the progress of financial reforms toward the objectives outlined in the Financial Sector Development Policy Statement or as undertaken as reform measures. These criteria may include but not be limited to the following:

(a) The real growth of domestic financial resources and private savings held by the banking system;

(b) The reduction in the gap between the Bank of Zaire's lending rates of interest and the inflation rate;

(c) The increase in the real value of credit extended by the banking sector to the private sector;

(d) The broadening in the range of enterprises which commercial banks are financing in terms of size, sector of activity, and geographic area;and

(e) A shift from direct to indirect methods of controlling the money supply following successful and sustained macroeconomic stabilization.

2) Take measures to progressively reduce government budget deficits and take other steps to reduce the rate of inflation.

3) Continue its policy of liberalized interest rates.

4) Maintain a policy of market-based, floating official exchange rates and to ensure that the difference between the official and parallel exchange rates does not exceed twenty percent.

5) Practice a policy of full-cost fuel pricing.

6) Maintain a liberal policy concerning foreign trade in commodities, and not to introduce quotas on imports or exports, and to continue the announced program of tariff-rate reform which will progressively moderate effective rates of protection.

7) Maintain liberalized pricing policy and not to introduce administrative controls, ex ante or ex post, on prices of private goods and services.

8) Not finance with program funds the importation of pesticides.

Conditions Precedent Conditions precedent will apply to the disbursement of funds for commercial bank financing of private enterprises but will not affect disbursement of funds for technical assistance, studies, and program management. The Mission anticipates that approximately $5.8 million will be disbursed with each tranche.

1) Condition Precedent to First Disbursement for Commercial Bank Financing of Private Enterprises. Prior to any disbursement under the Program Agreement, or the issuance of any commitment documents pursuant to which disbursement will be made, to provide funding for commercial bank financing of private enterprises, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

(1) A written comprehensive statement of policy governing the development of the financial sector of Zaire ("Financial Sector Development Policy Statement"). The statement shall embody a liberal, private sector-oriented approach to financial sector reform and development and shall include, but not be limited to, objectives to promote commercial bank mobilization of private domestic financial resources; to foster a more active money market and interest rates representative of the real economic cost of funds; and to increase the amount of credit available to private enterprises. The statement will include specifically the following objectives for the financial sector under this program:

(a) By the end of the five year program, real financial resources mobilized by private commercial banks should be growing by at least 4 percent per year.

(b) Interest rates should be positive relative to inflation.

(c) Commercial banks should be financing a wider range of enterprises than before the program in terms of size, sector of activity, and geographic area.

(d) Most of the budget deficit of the GOZ should be financed from the market at market determined rates.

(e) No GOZ constraints should remain on bank interest rates or fee structures.

(f) Required reserves should be set at minimum levels necessary for stability and efficient growth of the banking system.

(g) Most of the required reserves should be held in the form of treasury bonds remunerated at market rates of intrest. Required reserves deposited at the Bank of Zaire also should be remunerated at market rates of interest subject to the conclusions of a study by the parties to this agreement.

(h) The Central Bank should be acting only as lender of last resort and should charge market-based interest rates.

(i) The GOZ should be moving to replace administrative credit ceilings (direct controls with indirect controls on credit that are automatically linked to mobilization of resources by the banking system.

(2) A list of persons and agencies designated to meet and consult with A.I.D. at six-month intervals, beginning no later than six months after the signing of the Program Agreement, in order to monitor compliance with the various conditions and covenants for the Program Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the program, and review the results of program activities.

2) Conditions Precedent to Second Disbursement for Commercial Bank Financing of Private Enterprises.
Prior to any disbursement under the Program Agreement, or the issuance of any commitment documents pursuant to which disbursement will be made, to provide funding for commercial bank financing of private enterprises, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

As discussed in the regular six-month AID/GOZ Consultations, the GOZ will take specific steps and make substantial progress in:

(1) reducing commercial bank reserve requirements to minimum levels necessary for stability of the banking system;

(2) removing remaining constraints on bank interest rates or fee structures;

(3) reducing the gap between the rate of inflation and the Bank of Zaire money market rate;

(4) reducing total commercial bank obligations to the Bank of Zaire as a proportion of required reserves relative to the level of December 31, 1987 by at least five percentage points; and

The first Program Implementation Letter (PIL) will describe the specific degree of progress expected, given conditions at the signing of the Program Grant Agreement.

3) Recurring Conditions Precedent. Specific conditions precedent will be formulated for disbursement at six month intervals based on the results of the bi-annual AID/GOZ consultations on the implementation of the financial section development program and the GOZ's progress in attaining the objectives of that program.



14/

Prior to disbursements of subsequent tranches of funding for commercial bank financing of MSEs, the GOZ shall:

(a) Take those measures agreed upon with AID during the regular GOZ/AID program consultations to execute financial sector reforms, including measures aimed at attaining the specific objectives identified in the Financial Sector Development Policy Statement for the purpose of:

(1) promoting the mobilization by commercial banks of domestic financial resources and private savings;

(2) fostering a more active money market and interest rates more representative of the real economic cost of funds; and

(3) increasing the amount of credit in real terms available to the private sector.

(b) Demonstrate during the regular GOZ/AID program consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the program.

## IV. Committee Review and Findings

The Project Paper was reviewed at Issues and ECPR meetings held on June 13, 1988 and June 16, 1988 respectively and the PAAD was approved subject to the following modifications:

A. Project vs. Non-Project Assistance. The large CIP portion of the proposed project is Development Fund for Africa (DFA) non-project assistance and should be changed accordingly. The program was recast as a combined project/non-project assistance, with a PAAD facesheet added to reflect the CIP portion for $35,000,000 and the PP facesheet was changed to $5,000,000 for technical assistance. All references to project were changed to program.

This activity was, as originally presented, a banking reform project. Balance of payment as well as sectoral reform were provided as the underpinning for this activity. The ECPR noted that the sectoral reforms proposed provided the strong long-term development focus appropriate for DFA funding and that the paper should be revised to make it clear policy reform rather than the balance of payments benefits were the underlying basis for undertaking this activity. The program documentation was revised accordingly.

B. Project Goal and Purpose Presentation. The goal level must be more developmentally oriented showing the linkage to concerns with which A.I.D. normally operates. The ECPR recommended that the Financial Sector Development Policy [FSDP] Statement, which will serve as the framework for the program, be as clearly defined as possible.

The PAAD was modified to incorporate a clearer definition of the FSDP Statement. The statement will embody a liberal, private sector-oriented approach to financial sector reform and development and will include objectives to promote commercial bank mobilization of private domestic financial resources. More specific objectives which will serve as conditions precedents are included in the Executive Summary and in the body of the PAAD.

The ECPR also determined that program rationale and description should reflect clearer linkage and impact on the intended beneficiary group. The PAAD rationale section was augmented to demonstrate the linkages to and impact on the MSEs themselves, consumers, MSE employees, subcontractors, agriculture and rural areas as well as effects on the marketing and distribution chain.

C. Demonstrated Commitment by the GOZ. Given the importance of the IMF/World Bank Agreements to successful implementation of the program and that an agreement may not be signed this year, the question arose as to whether the program should be authorized. Mission representatives requested program approval and authorization so that the Mission could maintain a bargaining leverage should the negotiating climate improve as expected. The ECPR determined that before obligation can be authorized, substantive agreement must be reached on certain key issues before the Mission can go ahead with the program. The PAAD was modified to include three key prior actions that must occur prior to signature of the Grant Agreement. These actions are reduction in the gap between official and parallel exchange rates, reduction in the gap between inflation and the Bank of Zaire's interest rates, and evidence of revision in tax collection procedures including custom taxes, tax administration, and an increase in fuel taxes.

## V. Special Concerns

A. Relationship to Development Fund for Africa (DFA) Objectives: The PSSP is the central piece of USAID's private sector development strategy in Zaire. The program meets several specific objectives of the Development Fund for Africa (DFA) appropriation account contained in the Foreign Operations Export Financing and Related Programs Appropriations Act, 1989:

- To help overcome shorter-term constraints to long-term development;
- To bring about appropriate sectoral restructuring of the sub-Saharan African economies; and
- To establish a favorable environment for individual enterprise and self-sustaining development.

First, through its quick-disbursing assistance to medium and smaller-scale enterprises, the PSSP will help in reversing the decline in industrial production and in re-establishing demand and supply linkages between urban and rural areas.

Rejuvenation of Zaire's manufacturing industries is essential to broader economic recovery. Local industries use and process local products and distribute basic imports and consumer goods throughout the country. Second, the Zairian private sector requires an effective banking system. Financial sector reforms under the PSSP will result in increased credit to private enterprises through greater mobilization by banks of domestic savings and a more active money market.



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B. Local Currency Programming: Local currency generated from the PSSP will be used to support the Operating Expenses Trust Fund and the bilateral portfolio. It is estimated that approximately $2.8 million equivalent will be used for the Trust Fund, $15.1 million for the health sector and $17.1 million for the agricultural and infrastructure sector.

Although recent guidelines for the use of DFA funds require that local currency be used in support of the proposed sector reform program, the Mission requests that an exception be made so that local currency generations can be used not only within the private sector, but also in other relevant sectors. A portion of the local currency generations will be used to support a local currency bank loan program; however, the total amount used in this program component will be contingent upon established money supply ceilings as dictated by the Structural Adjustment Program. Other uses will include related research, evaluation and impact studies; surveying informal sector savings and credit activities; and surveying private sector business development opportunities. Because of the above mentioned money supply limitations and a lack of other viable private sector options for local currency programming, it is proposed that the majority of the local currency generations be used to support USAID/Zaire's development strategy in more targeted, but related areas such as agriculture, rural transport and health. Support in these areas will help improve Zaire's general economic recovery. General economic recovery combined with an effective commercial banking sector are prerequisites for a dynamic private sector.

Also, the Mission continues to have one of the best records within the Africa Bureau for effective monitoring of local currency generations. The GAO as well as the Inspector General's Office have cited the Kinshasa Mission as exemplary in their programming and monitoring of local currency generations. Because local currency generations have been effectively programmed to support the bilateral portfolio, A.I.D. projects in Zaire have been implemented on a more timely basis when compared to delays experienced by other donors due to a lack of local currency generations. The Mission believes that because of this record and the recognized need to support the bilateral projects, an exception should be granted to allow support of the project portfolio rather than used exclusively within the banking sector.

C. IEE:

After consultation with the Regional Legal Office serving Zaire and the Regional Environmental Officer (REDSO/WCA) during preparation of the PID, a categorical exclusion was recommended and approved by the Africa Bureau Environmental Officer and GC/AFR.

D. Implementation Agencies:

The Program Agreement will be signed by the Minister of Plan. A bank circular signed by the Bank of Zaire will make clear to all participants eligibility criteria for borrowers and commodities, implementation procedures, and monitoring and reporting requirements.

E. Responsible Officers:

G. William Anderson, Chief, USAID/PDO in Zaire, is the officer responsible for the program in the field. Don Clark, Chief AFR/PD/CCWAP, is the officer responsible for the program in AID/W.

F. Statutory Checklists:

Are attached to the PAAD.

G. Gray Amendment:

The PID recommended full and open competition in the choice of contractors. CBD notices and instructions to offerors will contain language encouraging "participation to the maximum extent possible of small business concerns, small disadvantaged business concerns and woman-owned small business concerns.... as prime contractors or subcontractors."

H. Source and Origin of Commodities, Nationality of Services:

The nationality for services, including ocean transportation services, and the source and origin of commodities financed under the project shall be as set forth in the Africa Bureau instructions on Implementing Special Procurement Policy Rules Governing the Development Fund for Africa (DFA), dated April 4, 1988, as may be from time to time amended.

I. Local Costs:

Dollar disbursements for local costs are not expected and will not be made unless such disbursements are made in accordance with the requirements of Handbook 1B, Chapter 18.

J. Notification to Congress:

The Congressional Notification for this program was forwarded on May 5, 1989. The fifteen day waiting period expired May 19, 1989 without objection.

V. Recommendation: The Africa Bureau ECPR reviewed and approved the PSSP on June 16, 1988 and found the program to be technically, economically, financially, socially, and administratively sound. However the program was not authorized at that time because the GOZ had not signed a Structural Adjustment Program with the World Bank (WB) and International Monetary Fund (IMF). A New Structural Adjustment Program is now in its final stages of approval and should be signed by the end of May, 1989. A Letter of Intention has been signed by the GOZ. Given the GOZ's reconcilation with the WB/IMF, conditions now seem appropriate for approval of this program. It is recommended that you: (i) sign the attached PAAD facesheet and the project authorization and thereby approve in principle life of program funding of the PSSP of $40 million. Specifically you will approve a PAAD for $14,000,000 for FY 1989 and a PP authorization for $5,000,000 in project assistance; and (ii) approve the Mission's request to use local currency generations from this program to support the general project portfolio.

Attachment: PAAD

Clearances:

| | | | |
|---|---|---|---|
| DAA/AFR:ELSaiers | [signature] | Date: | 5/23/89 |
| DAA/AFR:WBollinger | | Date: | |
| AFR/PD:TBork | [signature] | Date: | 5/23/89 |
| GC/AFR:JKnott | [signature] | Date: | 5/22/89 |
| AFR/DP:JWestley | | Date: | |
| AFR/CCWA:JColes | | Date: | 5/ /89 |
| M/FM:EOwens | | Date: | |
| PPC/PB:RMaushammer | [signature] | Date: | 5 18 89 |
| AFR/CONT:RKing | | Date: | |



18X

PROJECT AUTHORIZATION

Name of Country: Republic of Zaire

Name of Project: Private Sector Support

Number of Project: 660-0120

1. Pursuant to the Foreign Assistance Act of 1961, as amended, and the provisions of the appropriations heading "Sub-Saharan Africa, Development Assistance", contained in the Foreign Operations, Export Financing, and Related Programs Appropriations Act 1989, I hereby authorize the project component of the Private Sector Support Program for the Republic of Zaire, ("Cooperating Country") involving planned obligations of not to exceed $5,000,000 in grant funds ("Grant"), over a six-year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project component. The planned life of the project is five years from the date of initial obligation.

2. The project component will finance technical assistance studies and evaluations required for the Cooperating Country to achieve the objectives under the Private Sector Support Program (PSSP). The PSSP consists of assistance to: (1) provide both foreign exchange and local currency for short- and medium-term lending by commercial banks to medium- and small-scale Zairian private enterprises and (2) support a reform of the Zairian financial sector to enable commercial banks more efficiently to mobilize and allocate financial resources to private enterprises.

3. The Project Agreement which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Source and Origin of Commodities, Nationality of Suppliers. The nationality for suppliers of services, including ocean transportation services, and the source and origin of commodities financed under the project component shall be as set forth in the Africa Bureau Instructions on Implementing Special Procurement Policy Rules Governing the Development Fund for Africa (DFA) dated April 4, 1988, as may be amended from time to time.

b. Conditions Precedent to Signing the Project Grant Agreement and Program Grant Agreement. Prior to signature of the Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D., evidence that it has taken the following actions:

- Reduced the gap between the official and parallel exchange rates, particularly through devaluation of the officical exchange rates;

- Reduced the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revised the Government of Zaire's (GOZ) tax collection procedures including custom taxes, tax administration, and increased fuel taxes.

c. Condition Precedent to First Disbursement. Prior to any disbursement, or the issuance of any commitment documents under the Project Grant Agreement, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., a statement of the names and titles of persons who will act as representatives of the Cooperating Country under the Project Agreement, together with a specimen signature of each person specified in such statement.

d. Condition Precedent to Disbursement for Local Cost Financing. Prior to disbursement under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, to finance local costs, the determinations required by Chapter 18A1c of A.I.D. Handbook 1, Supplement B, shall have been made.

Walter Bollinger
Assistant Administrator
Bureau for Africa

Date: 5/24/89

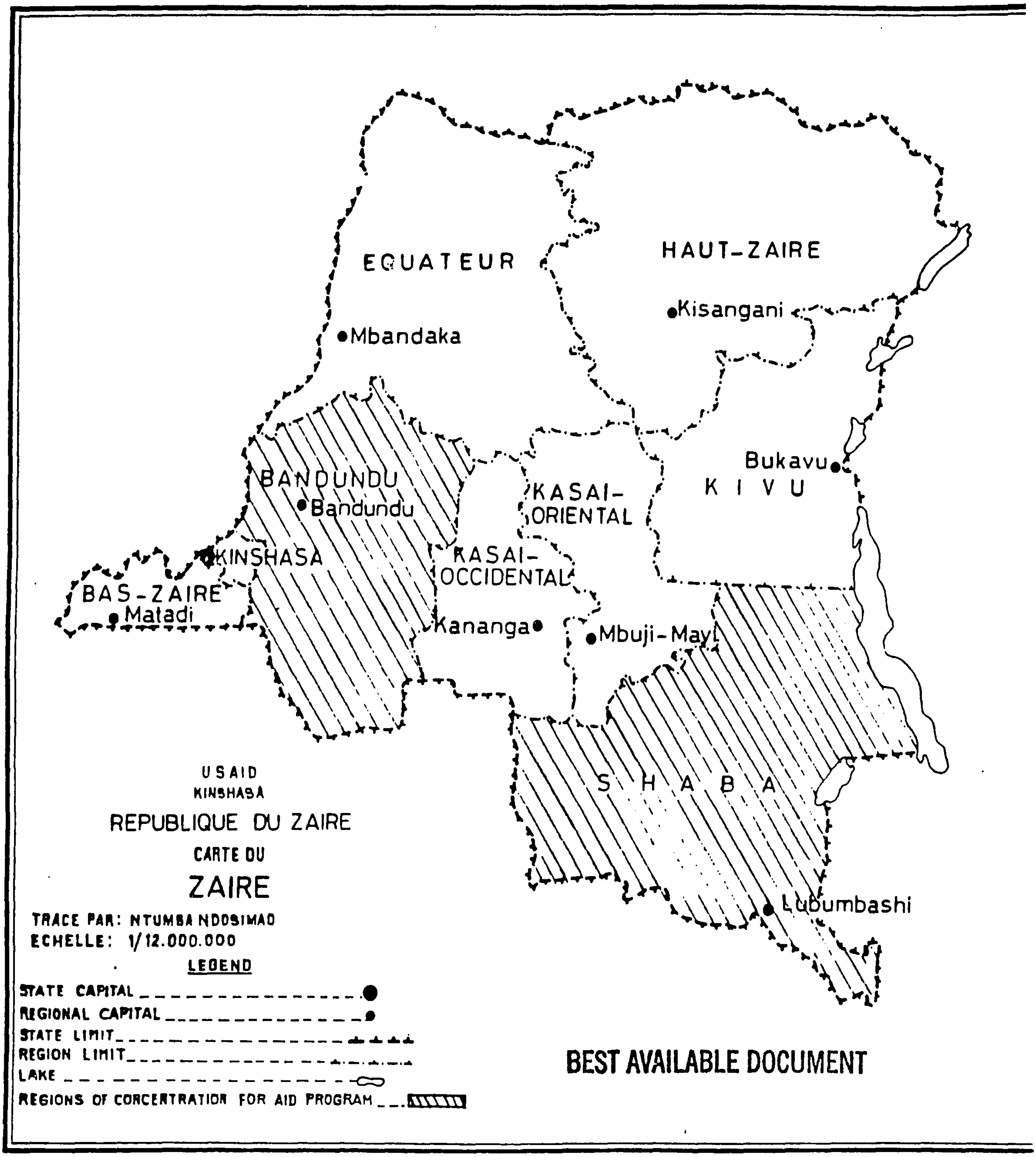
Clearances:

| | | | |
|---|---|---|---|
| AFR/DP:JWestley | | Date: | |
| AFR/PD:TBork | | Date: | 5/22/89 |
| AFR/CCWA:JColes | | Date: | 5/17/89 |
| DAA/AFR:ELSaiers | | Date: | 5/23/89 |

GC/AFR:JKnott JK

## List of Acronyms

| | |
|---|---|
| AEPRP | African Economic Policy Reform Program |
| AFECOZA | Association des Femmes Commercantes Zairoises |
| AFGRAD | African Graduate Fellowship Program |
| A.I.D. | Agency for International Development |
| ANEZA | Association Nationale des Entreprises Zairoises |
| BACAZ | Banque Continentale Africaine au Zaïre |
| BCA | Banque de Crédit Agricole |
| BCZ | Banque Commerciale Zaïroise |
| BDP | Banque du Peuple |
| BDZ | Bank du Zaire (Central Bank) |
| BEDEPE | Bureau d'Encouragement au Développement des Petites Entreprises |
| BIAZ | Banque Internationale de l Afrique au Zaire |
| BOP | Balance of Payments |
| BZCE | Banque Commerciale Zaïroise du Commerce Extérieur |
| CDSS | Country Development Strategy Statement |
| CIP | Commodity Import Program |
| CPF | Counterpart Fund |
| DFA | Development Fund for Africa |
| FSAC | Financial Sector Adjustment Credit (World Bank) |
| GOZ | Government of Zaïre |
| HRDA | Human Resources Development in Africa Project |
| IFC | International Finance Corporation |
| ILO | International Labor Organization |
| IMF | International Monetary Fund |
| ISAC | Industrial Sector Adjustment Credit |
| IEE/CE | Initial Environmental Examination/Categorical Exclusion |
| LCLP | Local Currency Loan Program |
| L/C | Letter of Credit |
| L/COM | Letter of Commitment |
| MSE | Medium and Smaller-Scale Enterprises |
| NBK | Nouvelle Banque de Kinshasa |
| OPEZ | Office for Promotion of Small Enterprise |
| PDO | Project Design and Operations Office - USAID/Kinshasa |
| PID | Project Identification Document |
| PMU | Project Management Unit |
| PP | Project Paper |
| PSC | Personal Services Contractor |
| PSSP | Private Sector Support Project |
| SAL | Structural Adjustment Loan (World Bank) |
| SAP | Structural Adjustment Program |
| SOFIDE | Societe Financiere de Developpment (development bank) |
| SONAS | Societe Nationale d'Assurances (National Insurance Company) |
| USAID | United States Agency for International Development |
| UNDP | United Nations Development Program |




BEST AVAILABLE DOCUMENT

## EXECUTIVE SUMMARY

| | |
|---|---|
| **Grant:** | $40.0 million for disbursement over three years with $16,000,000 to be obligated in FY 1989. |
| **Grantee:** | Government of Zaire (GOZ) |
| **Implementing Agency:** | Office of the Minister of Plan. |

### 1. The Problem.

The Zairian economy is in a recession characterized by high inflation, foreign exchange shortages, and decreasing production of manufactured goods. Manufacturing has declined relatively from 8 percent of GDP in 1970 to 6.2 percent of GDP in 1984 and absolutely over the same period by almost 20 percent in real terms. The private sector must play a leading role in Zaire's economic recovery. However, medium and smaller-scale manufacturing enterprises are operating at average capacity levels below 50 percent. They are constrained by a lack of working capital (both foreign exchange and local currency) which prevents them from purchasing adequate raw materials, spare parts, and replacement equipment. Longer term credit for expansion is unavailable. Therefore, they can neither operate at profitable levels of capacity nor expand. Commercial banks are unable and unwilling to meet these needs because of high inflation, foreign exchange shortages and a wide gap between official and parallel foreign exchange rates. Further, because of rigid credit ceilings, steep reserve requirements, and negative interest rates, banks have few economic incentives to seek greater private deposits and thus increase local resources for lending.

At the micro-economic level, workers in the productive sector are in danger of losing their jobs because of the long period of declining economic activity. Urban and rural consumers lack basic consumer goods, such as soap, cloth, matches, basic wood and metal products. Farmers have less demand for food and other agro-industrial products, such as jute and palm oil and therefore less incentives to produce. Distributors and wholesalers who sell MSE products have fewer goods to sell and less credit by which to market them. Finally, smaller enterprises which provide ancillary goods and services to larger companies find less demand for their products.

Other AID-financed interventions targeted on agriculture, transport, and health are threatened. Without an expanding private sector boosting production and income, revenues cannot increase to pay for road maintenance, agricultural extension, health care systems and other essential public services and investments. Unless these public investments can be made, the impacts of specific development projects cannot be sustained after projects end.

### 2. The Private Sector Support Program (PSSP)

The PSSP's purpose is to restructure the Zairian commercial banking sector to enable it to support productive investment by medium and smaller-scale enterprises (MSEs). The PSSP will help reverse the decline in industrial production and re-establish demand and supply linkages between urban and rural areas.

The program will facilitate restructuring and reform of the commercial banking sector to support more productive investment by MSEs. As these financial sector reforms are taking effect, foreign exchange and local currency financing under a CIP mechanism will enable medium and smaller-scale enterprises in Zaire to purchase raw materials, spare parts, and replacement equipment and thus utilize idle plant capacity. Local currency financing will encourage MSEs to utilize more local products such as jute for making agricultural sacks and palm oil for soap production. Commercial bank financing of MSEs will occur at market rates of interest.

Rejuvenation of Zaire's manufacturing industries is essential to Zaire's economic recovery. In addition to using and processing local products, local industries also produce and distribute basic consumer goods throughout the country. To recover and expand, the Zairian private sector requires an effective commercial banking sector. Financial sector reforms under the PSSP will result in increased credit to private enterprises through two means. First, through monetary policy changes such as reduced reserve requirements and remuneration of reserves, commercial banks will enjoy an improved incentive framework for mobilization of private savings. Second, because of experience during the program with MSE lending and because of a growing level of domestic financial resource mobilization, participating banks will begin to provide term credit to a wider range of enterprises as defined by size, sector of activity, and geographic location.

A full program of studies, annual impact surveys, and evaluations at both sectoral and micro-levels will collect gender-disaggregated data and track beneficiaries, expansion of rural-urban linkages, and other program impacts. Results of these studies and surveys will identify other constraints to private sector and particularly small-scale and women-owned enterprise development that can be addressed through other interventions.

1) Beneficiaries

Medium and smaller enterprises (MSEs) receiving financing from commercial banks will increase their production, capacity utilization, and profitability. The ultimate beneficiaries of the program are the workers in private enterprise borrowers, consumers, and smaller urban and rural producers. These beneficiaries will receive, respectively, increased employment and income, wider distribution of basic consumer goods at lower prices, and improved urban markets for the agricultural and other products they produce.

Workers in MSEs receiving credit will receive higher salaries, benefits, and further training opportunities. Urban and rural consumers will enjoy broader access to basic consumer goods (such as soap, basic wood and metal products, and cloth) throughout the country. Smaller distributors and wholesalers linked to MSE borrowers will benefit from more goods to sell and renewed distributor credit to assist sales. Smaller suppliers and subcontractors for MSEs, including farmers, who supply agro-industrial products (such as jute and palm oil for the manufacture of agricultural sacks and soap), will enjoy more demand for their products and services.

2) Addressing Foreign Exchange Shortage And Short-Term Credit Constraints

The program will provide $35 million in foreign exchange and $13.5 million in local currency for short-term and medium-term lending by commercial banks to medium and smaller-scale Zairian private enterprises. The availability of significant additional amounts of foreign exchange and local currency for lending will help stabilize the market for foreign exchange and encourage further liberalization. Private sector activity will increase while financial sector reform and development are occurring. The foreign exchange will be used to import essential raw materials, spare parts, and equipment. Local currency will be used to purchase similar materials available locally or for agricultural buying campaigns and will help re-establish rural-urban linkages as well as increase demand for agricultural products.

Participating private enterprises drawing on the program's foreign exchange or Counterpart Funds must repay the Counterpart Fund in local currency. The banks will originate and guarantee short- and medium-term local currency loans made from the CPF to the enterprises to pay for local costs. The banks' repayment obligations to the Counterpart Fund will be independent of the repayment of the borrowers' loans, so the banks will bear the commercial lending risk. The terms of repayments to the Counterpart Fund will cover credit terms established by the banks. Participating local commercial banks will open letters of credit for imports in a Commodity Import Program (CIP) process, and will collect local currency repayments from borrowers on behalf of the Counterpart Fund. U.S.-based banks selected for the Project will provide letter of credit confirmation services and effect payment to exporters on the basis of AID/W issued Bank Letters of Commitment.

Furthermore, the program will provide long and short-term technical assistance to monitor commercial bank financing of private enterprises and to identify further obstacles to domestic resource mobilization and allocation to the private sector. As measures are identified to deal with these problems, they will be included in future years of the PSSP or in future projects.

3) Restructuring the Financial Banking Sector

The program will facilitate development of the financial sector, which by the end of the program will be able to more efficiently mobilize and allocate financial resources to private enterprises. The program will support the process of financial sector reform through policy conditionality and by promoting mutual consultation between the GOZ and USAID on progress and performance in meeting the objectives and elements of the financial sector development program. Commitments of funds for imports will occur in tranches in coordination with progress in the financial sector development program.

This component will provide resources of $5 million in project funds and $1.5 million in local currencies for technical assistance, studies, fiduciary bank services, audits, and evaluation. These resources will help the GOZ implement its financial sector reform program that will provide the overall structure and incentives for the commercial banking system to mobilize resources for on-lending to the private sector.

The GOZ, through its central bank, the Bank of Zaire (BDZ), has agreed that the United States will, in the context of the Private Sector Support Project, participate in formulating and assisting the financial sector development program. There will occur regular consultations to implement this participation in the framework of the FSAC. Close contact with the private commercial banks will continue to be maintained.

Prior Actions

Prior to signature of the grant agreement, the GOZ must have taken substantial measures manifesting its intention to continue its overall macroeconomic program of structural reform and adjustment. Specifically, the GOZ will have taken the following prior actions:

- Reduction in the gap between the official and parallel exchange rates, particularly through devaluation of the official exchange rate;

- Reduction of the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revisions in taxes and in tax administration to progressively reduce the GOZ's budget deficit.

The policy reform program under the PSSP will consist of three parts.

o Commitments by the GOZ to specific objectives in financial sector development and to U.S. participation in designing and supporting this program will be conditions precedent to the initial release of funds for import financing.

o Specific measures promoting domestic resource mobilization by banks and allocation of these resources to the private sector will be conditions precedent to subsequent releases of program funding. Two of the priority areas for conditionality are: 1) promoting a more active money market among banks and other financial institutions, so as to establish truly market-determined interest rates, and (2) improving the incentive framework for banks to mobilize a larger share of national liquidity and thereby expand credit available to the private sector.

Basic covenants will establish the macro-economic framework required for the PSSP to succeed, including provisions for control of the deficit and liberalization of prices, interest rates, and exchange rates.

The GOZ and USAID will consider conditionality recommendations and actions to be taken in future years. Bank of Zaire interest rates, lending policies, reserve requirements and credit ceilings will be areas of discussion. Requirements for progress in areas of particular interest to AID will be conditions for subsequent releases of funding under the PSSP. The policy reform program will be supported by technical assistance, training and targeted research.

Program Management

Local commercial banks participating in the PSSP will offer foreign exchange facilities to eligible private sector importers using Commodity Import Program (CIP) mechanisms. USAID's management system for this type of operation has been developed through a series of three CIPs. A local bank acting as fiduciary will be contracted to manage local currency repayments to the Counterpart Fund and disbursements under the Local Currency Lending Program. A consulting firm with audit capabilities will monitor progress, results, and impacts of bank lending to MSEs under an institutional contract. Technical assistance for financial sector development and reform activities will be provided by long-term PSC and IQC mechanisms.

USAID staff will focus on (1) policy dialogue, (2) monitoring GOZ performance in satisfying conditionality, (3) formulating conditionality for subsequent tranched release of funds, (4) modifying reform targets and timetables to meet current conditions, (5) monitoring commodity transaction (6) managing studies and analyses to determine the actual impacts and implications of program activities and conditionality, and (7) managing the performance of the principal contractors in meeting program objectives.

## 1. PROGRAM RATIONALE AND DESCRIPTION

USAID/Zaire proposes to provide $40 million to restructure the Zairian commercial banking sector and enable it to support productive investment by medium and smaller-scale enterprises (MSEs). Of the $40 million, $35 million will be provided in non-project assistance under a CIP, and $5 million will be provided for technical assistance, studies, and evaluations.

### 1.1. The Problem

The Zairian economy is in a recession characterized by high inflation, foreign exchange shortages, and decreasing production of manufactured goods. Manufacturing has declined relatively from 8 percent of GDP in 1970 to 6.2 percent of GDP in 1984 and absolutely over the same period by almost 20 percent in real terms. The private sector must play a leading role in Zaire's economic recovery. However, medium and smaller-scale manufacturing enterprises are operating at average capacity levels below 50 percent. They are constrained by a lack of working capital (both foreign exchange and local currency) which prevents them from purchasing adequate raw materials, spare parts, and replacement equipment. Longer term credit for expansion is unavailable. Therefore, they can neither operate at profitable levels of capacity nor expand. Commercial banks are unable and unwilling to meet these needs because of high inflation, foreign exchange shortages and a wide gap between official and parallel foreign exchange rates. Further, because of rigid credit ceilings, steep reserve requirements, and negative interest rates, banks have few economic incentives to seek greater private deposits and thus increase local resources for lending.

At the micro-economic level, workers in the productive sector are in danger of losing their jobs because of the long period of declining economic activity. Urban and rural consumers lack basic consumer goods, such as soap, cloth, matches, basic wood and metal products. Farmers have less demand for food and other agro-industrial products, such as jute and palm oil and therefore less incentives to produce. Distributors and wholesalers who sell MSE products have fewer goods to sell and less credit by which to market them. Finally, smaller enterprises which provide ancillary goods and services to larger companies find less demand for their products.

Other AID-financed interventions targeted on agriculture, transport, and health are threatened. Without an expanding private sector boosting production and income, revenues cannot increase to pay for road maintenance, agricultural extension, health care systems and other essential public services and investments. Unless these public investments can be made, the impacts of specific development projects cannot be sustained after projects end.

Zaire embarked upon a far-reaching economic stabilization and liberalization program in 1983 in an attempt to overcome a long and severe economic crisis. The GOZ adopted many important policy reform measures. While adoption of these measures has often been unpopular and difficult - and progress in implementation uneven - the GOZ is determined to continue and expand its reform program.

Zaire, like most developing countries, depends upon a limited number of mineral and agricultural products for its foreign exchange earnings. While output response to the policy measures adopted under the reform program have been positive, international price movements have negated much of the foreign exchange gain expected from increased export quantities. This factor, combined with continued heavy debt repayment levels, has resulted over the past year in foreign exchange shortages. There is currently estimated to be a minimum structural shortage of roughly $10 million per month in short term trade credit, which banks could provide to the private sector if the foreign exchange were available.

Credit, which plummeted to one-third its 1974 level in 1982, has essentially stagnated since the beginning of the current stabilization program in 1983. This is partly the result of continued high and fluctuating inflation, which increases the risks of credit and has driven most firms back to self-financing of their operations. Restrictive credit policies adopted to stabilize total liquidity and inflation have also severely limited commercial banks' ability to extend credit. Zairian banks are subject to strict credit ceilings and are required to keep an interest-free reserve in the central bank equal to fifty percent of their short-term deposit base. Term credit is available only from the development bank. Due to high inflation and thin credit markets, interest rates, although no longer under government control, are not responsive to supply and demand. Several financial institutions need rehabilitation, although the core of the private commercial banking sector is sound. Zairian banks serve mainly as foreign-exchange dealers, concentrating primarily on very short-term trade financing, and limit their lending mainly to short-term advances to preferred clients.

### 1.2 The Private Sector Support Program (PSSP)

The PSSP's purpose is to restructure the Zairian commercial banking sector to enable it to support productive investment by medium and smaller-scale enterprises (MSEs). The PSSP will help reverse the decline in industrial production and re-establish demand and supply linkages between urban and rural areas.

The program will facilitate restructuring and reform of the commercial banking sector to support more productive investment by MSEs. As these financial sector reforms are taking effect, foreign exchange and local currency financing under a CIP mechanism will enable medium and smaller-scale enterprises in Zaire to purchase raw materials, spare parts, and replacement equipment and thus utilize idle plant capacity. Local currency financing will encourage MSEs to utilize more local products such as jute for making agricultural sacks and palm oil for soap production. Commercial bank financing of MSEs will occur at market rates of interest.

Rejuvenation of Zaire's manufacturing industries is essential to Zaire's economic recovery. In addition to using and processing local products, local industries also produce and distribute basic consumer goods throughout the country. To recover and expand, the Zairian private sector requires an effective commercial banking sector. Financial sector reforms under the PSSP will result in increased credit to private enterprises through two means. First, through monetary policy changes such as reduced reserve requirements and remuneration of reserves, commercial banks will enjoy an improved incentive framework for mobilization of private savings. Second, because of experience during the program with MSE lending and because of a growing level of domestic financial resource mobilization, participating banks will begin to provide term credit to a wider range of enterprises as defined by size, sector of activity, and geographic location.

A full program of studies, annual impact surveys, and evaluations at both sectoral and micro-levels will collect gender-disaggregated dta and track beneficiaries, expansion of rural-urban linkages, and other program impacts. Results of these studies and surveys will identify other constraints to private sector and particularly small-scale and women-owned enterprise development that can be addressed through other interventions.

1) Beneficiaries

Medium and smaller enterprises (MSEs) receiving financing from commercial banks will increase their production, capacity utilization, and profitability. The ultimate beneficiaries of the program are the workers in private enterprise borrowers, consumers, and smaller urban and rural producers. These beneficiaries will receive, respectively, increased employment and income, wider distribution of basic consumer goods at lower prices, and improved urban markets for the agricultural and other products they produce.

Workers in MSEs receiving credit will receive higher salaries, benefits, and further training opportunities. Urban and rural consumers will enjoy broader access to basic consumer goods (such as soap, basic wood and metal products, and cloth) throughout the country. Smaller distributors and wholesalers linked to MSE borrowers will benefit from more goods to sell and renewed distributor credit to assist sales. Smaller suppliers and subcontractors for MSEs, including farmers, who supply agro-industrial products (such as jute and palm oil for the manufacture of agricultural sacks and soap), will enjoy more demand for their products and services. The program will monitor and evaluate benefits and effects on the following:

Consumers: Access to foreign currency through the program will enable target MSEs to import essential raw materials and spare parts, thus lowering unit costs of production. These savings should be passed on to the consumer because many companies compete with imports and also face declining purchasing power due to inflation.

Employees: Manufacturing companies provide a training ground for mechanics, engineers and office workers. This on-site training is of superior quality compared to other training resources in Kinshasa. MSEs are also a source of stable, long term employment in a rapidly expanding urban economy. Benefits for workers include dispensaries, medicines, payment of culturally important expenses such as funerals and marriages, retirement benefits, and access to food at below-market prices.

Subcontractors: Medium scale companies subcontract work to smaller enterprises such as printshops, wholesale food traders, laundry and transport services.

Marketing and Distribution Chain: Many companies have national distribution networks; some have branch factories in the interior. Most companies have recently cut back or eliminated distributor credit. Increased access to local currency enables companies to reestablish distributor credit, thus expanding their distribution networks.

Links to Agriculture and Rural Areas: Most companies in the medium size range either operate in Kinshasa or have their headquarters there. The direct impact of the PSSP, therefore, will be felt in the large population center of the Kinshasa Region. With increased access to credit, those medium scale industries with branch factories and national distribution will be able to expand their activities in the interior.

Some companies have direct links with agriculture or buy raw materials in rural areas, specifically those producing building materials and foodstuffs. One company provides credit to traders for agricultural buying campaigns. Special studies for the PSSP will show how to strengthen these supply links. The local currency loan component will also provide credit for agricultural campaigns.

Specific MSE examples

Specific examples from background studies carried out for the program design illustrate the PSSP's range of benefits and linkages to smaller producers and other sectors A medium-sized brick company called BRIKIN manufactures bricks and tiles from local materials and needs credit to operate at a profitable level of capacity. BRIKIN has been in business since 1949 and exports bricks to the Congo and the Central African Republic as well as supplying the Zairian construction industry.

A food products company known as VAP (Victoria Assorted Products) manufactures various types of food products, including a weaning food using locally produced corn. VAP distributes its products throughout Zaire and purchases its corn from a Zairian PVO based in the Equateur Region. Credit, combined with the new machinery it has recently purchased, will enable VAP to expand its production of weaning food and other products.

TREFILKIN, a producer of basic metal products such as wire mesh, fencing, and nails, needs credit to expand its line of products to include galvanized tin roofing, widely used in Zaire. TREFILKIN also sells fencing to larger agricultural producers in the interior of Zaire.

MAZAL manufacturers matches using local wood as well as imported raw materials. MAZAL's marketing chain includes a variety of distributors, including street vendors, many of whom are women. Three of the company's wholesale clients are also women. The company needs credit for machinery to begin manufacturing match boxes locally instead of importing them.

The only factory in Zaire with research facilities, PENAZA is owned by a Zairian woman who took over ownership from Belgians in the mid-1970s. PENAZA has production facilities in Kisangani, Likasi, and Lubumbashi as well as in Kinshasa and distributes its products through hardware stores all over the country. Because of the lack of credit, however, the company has had to reduce distributor credit from 90 to 30 days. The company uses local soy oil, copal, and cement as well as imported raw materials.

As a manufacturer of jute sacks, TISSAKIN has extensive links with the agricultural sector, especially small jute farmers in the Bandundu Region and traders who buy the jute for the company. In producing the sacks, which are essential for marketing of a wide range of agricultural products, TISSAKIN mixes higher quality imported jute from Bangladesh (1/4 of the total jute used) with local jute. Because the company is unable to provide sufficient credit to traders for purchasing local jute, the traders are slow in buying from farmers, who then have less incentive to gather more jute. Moreover, TISSAKIN competes with sacks imported from Bangladesh.

These examples illustrate the variety of demand and supply linkages local Zairian companies have with rural and urban producers, consumers, distributors, and even micro market vendors. All of these companies are established companies with substantial idle capacity. Sufficient credit for local and imported raw materials and equipment could quickly expand these companies' operating capacities and benefit their employees and consumers as well as smaller-scale suppliers and distributors.

2) Addressing Foreign Exchange Shortage And Short-Term Credit Constraints

The program will provide $35 million in foreign exchange and $13.5 million in local currency for short-term and medium-term lending by commercial banks to medium and smaller-scale Zairian private enterprises. The availability of significant additional amounts of foreign exchange and local currency for lending will help stabilize the market for foreign exchange and encourage further liberalization. Private sector activity will increase while financial sector reform and development are occurring. The foreign exchange will be used to import essential raw materials, spare parts, and equipment. Local currency will be used to purchase similar materials available locally or for agricultural buying campaigns and will help re-establish rural-urban linkages as well as increase demand for agricultural products.

Participating private enterprises drawing on the program's foreign exchange or Counterpart Funds must repay the Counterpart Fund in local currency. The banks will originate and guarantee short- and medium-term local currency loans made from the CPF to the enterprises to pay for local costs. The banks' repayment obligations to the Counterpart Fund will be independent of the repayment of the borrowers' loans, so the banks will bear the commercial lending risk. The terms of repayments to the Counterpart Fund will cover credit terms established by the banks. Participating local commercial banks will open letters of credit for imports in a Commodity Import Program (CIP) process, and will collect local currency repayments from borrowers on behalf of the Counterpart Fund. U.S.-based banks selected for the Program will provide letter of credit confirmation services and effect payment to exporters on the basis of AID/W issued Bank Letters of Commitment.

Furthermore, the program will provide long and short-term technical assistance to monitor commercial bank financing of private enterprises and to identify further obstacles to domestic resource mobilization and allocation to the private sector. As measures are identified to deal with these problems, they will be included in future years of the PSSP or in future projects.

3) Restructuring the Financial Banking Sector

The program will facilitate development of the financial sector, which by the end of the program will be able to more efficiently mobilize and allocate financial resources to private enterprises. The program will support the process of financial sector reform through policy conditionality and by promoting mutual consultation between the GOZ and USAID on progress and performance in meeting the objectives and elements of the financial sector development program. Commitments of funds for imports will occur in tranches in coordination with progress in the financial sector development program.

This component will provide resources of $5 million in project funds and $1.5 million in local currencies for technical assistance, studies, fiduciary bank services, audits, and evaluation. These resources will help the GOZ implement its financial sector reform program that will provide the overall structure and incentives for the commercial banking system to mobilize resources for on-lending to the private sector.

The GOZ, through its central bank, the Bank of Zaire (BDZ), has agreed that the United States will, in the context of the Private Sector Support Program, participate in formulating and assisting the financial sector development program. There will occur regular consultations to implement this participation in the framework of the FSAC. Close contact with the private commercial banks will continue to be maintained.

Prior Actions.

Prior to signature of the grant agreement, the GOZ must have taken the substantial measures manifesting its intention to continue its overall macroeconomic program of structural reform and adjustment. Specifically, the GOZ will have taken the following prior actions:

- Reduced in the gap between the official and parallel exchange rates, particularly through devaluation of the official exchange rate;

- Reduced the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revised the GOZ tax collection procedures including custom taxes, tax administration, and an increase fuel taxes.

The policy reform program under the PSSP will consist of three parts.

o Commitments by the GOZ to specific objectives in financial sector development and to U.S. participation in designing and supporting this program will be conditions precedent to the initial release of funds for import financing.

o Specific measures promoting domestic resource mobilization by banks and allocation of these resources to the private sector will be conditions precedent to subsequent releases of program funding. Two of the priority areas for conditionality are: 1) promoting a more active money market among banks and other financial institutions, so as to establish truly market-determined interest rates, and (2) improving the incentive framework for banks to mobilize a larger share of national liquidity and thereby expand credit available to the private sector.

o Basic covenants will establish the macro-economic framework required for the PSSP to succeed, including provisions for control of the deficit and liberalization of prices, interest rates, and exchange rates.

The GOZ and USAID will consider conditionality recommendations and actions to be taken in future years. Bank of Zaire interest rates, lending policies, reserve requirements and credit ceilings will be areas of discussion. Requirements for progress in areas of particular interest to AID will be conditions for subsequent releases of funding under the PSSP. The policy reform program will be supported by technical assistance, training and targeted research. Refer to Section 6, <u>Conditions and Covenants</u> for a more detailed discussion of the conditionality.

(4) <u>Program Management</u>

Local commercial banks participating in the PSSP will offer foreign exchange facilities to eligible private sector importers using Commodity Import Program (CIP) mechanisms. USAID's management system for this type of operation has been developed through a series of three CIPs. A local bank acting as fiduciary will be contracted to manage local currency repayments to the Counterpart Fund and disbursements under the Local Currency Lending Program. A consulting firm with audit capabilities will monitor progress, results, and impacts of bank lending to MSEs under an institutional contract. Technical assistance for financial sector development and reform activities will be provided by long-term PSC and IQC mechanisms.

USAID staff will focus on (1) policy dialogue, (2) monitoring GOZ performance in satisfying conditionality, (3) formulating conditionality for subsequent tranched release of funds, (4) modifying reform targets and timetables to meet current conditions, (5) monitoring commodity transaction (6) managing studies and analyses to determine the actual impacts and implications of program activities and conditionality, and (7) managing the performance of the principal contractors in meeting program objectives.

## 1.3 PSSP Relationships with National Development Objectives and Strategies

The Private Sector Support Program has been designed to take into account fundamental GOZ, IMF/World Bank, and USAID development objectives in general, and banking sector reform and private sector development goals in particular.

(1) <u>Conformity Of PSSP With Zaire's Development Strategy And Programs</u>

The GOZ's economic program until 1976 concentrated on taking control of Zaire's economic assets from expatriate owners -- nationalization in the mining sector, Zairianization in agroindustry and commerce -- and on large-scale public investments -- a steel mill and very large-scale energy-sector projects. This program was brought to a halt by the decline in the terms of trade, the poor performance of both public sector and Zairianized industries, and the costs of the defense of the Shaba region from armed incursions in 1977 and 1978. Annex 3, <u>The Economic Analysis</u>, discusses these developments in more detail.

After a transitional period, the GOZ began to focus on economic stabilization. There are several aspects to this stabilization program.

- The GOZ has tried to adjust its fiscal program to its reduced resources. The GOZ signed its first Stand-By Agreement with the IMF in 1976. The current Stand-By Agreement, approved in 1987, is Zaire's seventh. Each program has concentrated heavily on raising fiscal revenues and controlling spending.

- The growth of private credit has also been controlled in the framework of the Stand-By Agreements.

- The GOZ is encouraging the private sector to play a more important role in production and commerce, concentrating public sector activities on infrastructure, social programs and specified state enterprises such as copper mining. Retrocession of Zairianized and nationalized enterprises started in 1976. Most agricultural marketing parastatals were eliminated in a reorganization in 1978. Privatization is an element of the Structural Adjustment Program.

- The GOZ in 1983 began the current and ongoing economic stabilization program which has focused on liberalization of the regulatory framework for the private sector. The GOZ has eliminated controls on agricultural and manufactured commodity prices as well as on imports, although implementation of decontrol has not been complete. Exchange rates were freed from control from 1984 through 1986. Since exchange rate control was resumed in October, 1986 the currency has been devalued regularly in an attempt to keep pace with parallel market rates. Controlled fuel prices have been adjusted several times since August, 1987 to ensure that costs are covered. Repatriation of profits is now allowed. Import tariffs are being made more uniform, encouraging more use of local resources in production and consumption.

Despite continuing pressure on the balance of payments, the GOZ is moving ahead with a Structural Adjustment Program, of which the phases inaugurated in 1986 and 1987 focus primarily on tariff, civil service, privatization and parastatal management reforms. The continuation of this program in 1988 and 1989 is planned to emphasize three areas that have been under study for some time: small and medium enterprises, the financial sector, and agriculture.

The Private Sector Support Program also has the medium-term objective of developing improved commercial banking services to medium-size and smaller private enterprises (MSEs), a group whose businesses are smaller in size than the banking system's current clientele. This objective corresponds to two of the three emphases in the Structural Adjustment Program: the financial sector and small and medium enterprises.

With respect to the financial sector, the joint World Bank and the IMF have initiated discussions in financial sector development and credit policy as part of the 1987 Structural Adjustement Program. Under this program, the requirement for Bank of Zaire approval of agricultural and medium term loans was eliminated, agricultural interest rates were freed from control, allocation of credit ceilings was streamlined, and the turnover tax on interest earnings was eliminated. Some progress was also made in discussing agricultural credit policy, regulating savings and credit cooperatives, and improving regulation of commercial banks.

This financial sector element is to be expanded in 1988 through the World Bank's Financial Sector Adjustment Credit (FSAC). The overall objectives of the FSAC are to substitute indirect for direct regulation of the financial sector, to improve the mobilization of resources and to increase the availability of credit. The priority measures will be to improve control over the money supply and the working of credit and financial markets. Other measures will be taken to increase the stability of the financial system and to restructure certain financial institutions.

The Private Sector Support Program has been designed as an integral part of these efforts. It concentrates on the private commercial banking sector and the problem of increasing this sector's deposit base and lending volume in the context of the overall macroeconomic program's limitations on total liquidity in the economy. Discussions with the Bank of Zaire, as well as with the World Bank, have encouraged this approach. They have also confirmed that financing mechanisms proposed in this program will not conflict with IMF stabilization targets and credit ceilings. The IMF will take account of the PSSP's projected level of activity in establishing with the BDZ credit ceilings.

The GOZ has shown continuing interest in small and medium enterprise promotion as an important element in the Structural Adjustment Program evidenced by a series of roundtable discussions and new initiatives over the last year. A major activity in this field is the new World Bank Small Enterprise Promotion Project. The GOZ has also established an Office for Promotion of Small Enterprise (OPEZ) and has engaged in small enterprise projects with the UNDP and the French technical assistance agency, through OPEZ and the national chamber of commerce, ANEZA. The two development banks, SOFIDE and the Agricultural Development Bank (BCA), also have small and medium enterprise promotion among their objectives.

While USAID has supported OPEZ, SOFIDE, and the BCA with training and some Counterpart Fund deposits, the Private Sector Support Program proposes a purely private sector approach to promotion of MSEs. Discussions with the Prime Minister's Office, the Planning Ministry and the directors of all major departments of the BDZ (studies, credit, banking supervision, and the Small Enterprise Development Office) have indicated the GOZ's strong interest in this effort.

(2) Relationship Of The PSSP To AID Strategy

The World Bank has requested that donors to Zaire shift assistance into faster disbursing modes to the extent possible. The World Bank itself adopted a major program assistance strategy for Zaire in 1985, which has resulted so far in two major program loans, the Industrial Sector Adjustment Credit (ISAC) in 1986 and the Structural Adjustment Loan (SAL) in 1987. Several other donors are co-financing these programs or supporting them through informally linked assistance to the balance of payments. The Paris Club of official creditors to the GOZ granted exceptional rescheduling terms to Zaire in 1987, a measure which the United States fully supported.

USAID/Zaire's CDSS dates from 1984, with an Update in early 1985. Since 1984, USAID's strategy has placed increasing emphasis on balance of payments assistance, policy conditionality, and the private sector. This is evident in the CDSS Update of 1985 with its emphasis on "stabilization support." This emphasis was strengthened in 1986 by the Africa Bureau's allocation of AEPRP funds to Zaire for the Structural Adjustment Support Grant (660-0121).

USAID will propose a major three-year PL 480, Title I/III, program for FYs 1989-1991, in support of the balance of payments and policy reform promoting agricultural production and marketing. USAID is investigating the possibility of a privatization project for FY 1989, which could also be funded by the AEPRP if funds are available and allocated to Zaire. USAID will continue major projects in health, population, rehabilitation of rural roads, and agricultural production. However, for the benefits of these development projects to be sustained over time, the Zairian economy, and the private sector in particular must increase production, income, and revenues. With increased income and revenues, public services and investments can be maintained and expanded.

USAID expects the new CDSS to be completed early in 1989 to continue to reflect a focus on private sector development. The mission considers the Private Sector Support Program a central element in this strategy, which is expected to include a set of interventions directed toward promoting private enterprise. The present program is expected to benefit mainly MSEs. Studies indicate that special, dedicated activities will be needed to reach micro-enterprises and address more fully women-in-development requirements. The Social Soundness Analysis, Annex 4, addresses these issues, including spread effects from the PSSP and special studies under the Program to better understand these sectors. USAID is considering small and micro-enterprise support under the Small Project Support Project (660-0125) scheduled for authorization in early FY 1989.

The Private Sector Support Program continues USAID's strategy of using private commercial banks as implementing institutions in assisting the private sector. The PL 480 program and three CIPs (660-0100, 660-0103, and the AEPRP-financed CIP, 660-0121) have enhanced the Mission's familiarity and expertise with the private commercial banks in allocating external financial assistance to the private sector. CIP evaluations have found that this method is working well. This mechanism will, however, be elaborated further in the Private Sector Support Program. The program will seek to stimulate a wider range of banking services such as term credit to a new clientele of MSEs.

The program's emphasis on the private sector, the financial sector, and MSEs fully reflects the mission's analysis of these as critical constraints on the objective of improving the standard of living of Zaire's poor majority. Progress in these areas is necessary to permit the Zairian economy to resume growth and to make up for the post-1974 income losses, which, as the CDSS points out, are at the root of many of the daily problems of the target population.

## 1.4 Relationship Of The PSSP To Development Fund For Africa (DFA) Legislation

Among other objectives, Development Fund for Africa (DFA) legislation contained in the FY 1988 Continuing Resolution authorizes assistance:

- to help overcome shorter-term constraints to long-term development;
- to bring about appropriate sectoral structuring of the Sub-Saharan economies; and
- to establish a favorable environment for individual enterprise and self-sustaining development.

The Continuing Resolution further states that efforts at policy reform should take into account the need (1) to protect vulnerable groups and (2) the need for USAID to coordinate its programs with multilateral donors. The Conference Report states that "sectoral support designed to alleviate specific policy, institutional, or resource constraints in a recipient country's economy" is appropriate and that such sectoral approaches should "be integrated into a single country strategy whose different components complement one another...".

The PSSP has been designed to target funds to the private sector rather than to the GOZ, and to medium-size rather than larger firm. The PSSP is also conditioned on the GOZ's implementation of financial sector reform. Consequently, the program's impact will improve the medium-term economic environment for increased employment and income, improved supplies of consumption goods, and improved urban markets for agricultural products.

Success of the PSSP requires that the GOZ continue with its efforts to reduce inflation as well as the budget and balance of payments deficits. Without reasonable macroeconomic stability, the overall economy cannot function and specific development efforts in sectors such as agriculture and transport cannot succeed. Overall stability and economic recovery is essential to economic growth. Unless overall economic growth can occur, targeted efforts to help poorer and more vulnerable groups cannot be sustained.

A renascence of the private manufacturing sector is essential to a broader economic recovery in Zaire. Local industries use and process local products such as jute and palm oil and produce basic consumer goods widely used throughout the country. Marketing and distribution of these inputs and consumer goods occur through rail, river, and road transportation networks. These manufacturing, marketing, and distribution activities by private enterprises depend on a banking system that can meet their financial requirements for working capital, investment, and other needs. Financial sector reforms under the PSSP are aimed at increasing credit through the banking system to the private sector by improving incentives for banks to mobilize private savings and by promoting more freely market-determined interest rates.

The PSSP's objective of facilitating financial sector reform thus corresponds to the DFA and Continuing Resolution's objectives of (1) appropriate sectoral reform and (2) establishment of a favorable environment for individual enterprise and self-sustaining development. Private enterprises cannot survive or develop without a financial system that meets their needs. Further, as discussions in this Section and Annex 3, Economic Analysis, make clear, USAID/Zaire has engaged in close consultation with the World Bank and other multilateral donors in developing this program.

The FY 1988 Continuing Resolution's Conference Report language states that efforts at sectoral reform should form an integral part of AID country development strategies. Currently, USAID/Zaire's Action Plan objectives aim at:

1. structural reform and policy dialogue;

2. increasing agricultural production and productivity;

3. improving farm-to-market access; and

4. health and population.

AID-financed projects in agriculture, transport, and health aim at benefitting specific target groups, mostly rural. USAID/Zaire's efforts in structural reform aim at overall economic recovery. General economic recovery and stabilization as well as a vibrant private sector are essential to the sustainability of these more targeted sectoral projects. Without growing urban demand and production, rural production and consumption cannot increase. Unless rural areas and urban centers are linked more closely through private and public transport services and networks, development projects will not reap their potential benefits. Without increased ability of individuals and government to pay for improved health services, health status cannot improve. General economic recovery and an effective commercial banking sector are essential to create a dynamic private sector that is healthy and growing and that will enable more targeted development interventions to succeed. The PSSP focuses on enabling the commercial banking sector to support more productive investment by MSEs, thereby assisting the private sector to recover and grow at a faster pace.

The program also recognizes that structural and sector reform efforts can threaten vulnerable groups. The PSSP's planned monitoring and evaluation activities described in Sections 4 and 7 and Annex 6 discuss ways in which effects on vulnerable groups will be measured. A full program of studies, annual impact surveys, and evaluations at both sectoral and micro-levels will collect gender-disaggregated data and track beneficiaries, expansion of rural-urban linkages, and other program impacts. Results of these studies and surveys will identify other constraints to private sector and particularly small-scale and women-owned enterprise development that can be addressed through other interventions.

Local currency generated from the PSSP will be deposited in a special account specifically for the PSSP and used to support the USAID/Zaire Operating Expenses Trust Fund and the bilateral portfolio. It is estimated that approximately $2.8 million equivalent will be used for the Trust Fund, $15.1 million for the health sector and $17.1 million for the agricultural and infrastructure sector.

Although recent guidelines for the use of DFA funds require that local currency be used in support of the proposed sector reform program, the Mission argues that an exception be made for this program for the reasons as discussed above and because the Mission continues to have one of the best records within the Africa Bureau for effective monitoring of local currency generations. The GAO as well as the Inspector General's Office have cited the Kinshasa Mission as exemplary in their programming and monitoring of local currency generations. Because local currency generations have been effectively programmed to support the bilateral portfolio, A.I.D. projects in Zaire have been implemented on a more timely basis when compared to delays experienced by other donors due to a lack of local currency generations. The Mission believes that because of this record and the recognized need to support the bilateral projects, an exception should be granted to allow local currency generations to be used to support of the Mission's general project portfolio rather than used exclusively within the banking sector.

## 1.5 The PSSP Design Process

The PSSP Program Document draws on a three year period of intensive research, continuing dialogue with the GOZ, and close contacts with the World Bank, IMF, other bilateral donors and the commercial banks.

The identification of needs of private sector beneficiaries was a fundamental starting point for the mission in developing the PSSP. An Investment Climate Assessment was completed in the fall of 1985 based on private sector interviews in Kinshasa and Lubumbashi. This survey identified the private sector's unsatisfied credit needs and lack of access to foreign exchange as the keys to highly under-utilized production facilities. The survey also highlighted the need for specific policy and operational reforms required if the private sector was to develop its potential.

This original Investment Climate Assessment was followed by three more probing surveys of Zaire's private sector in 1987 and 1988. Carried out by Coopers & Lybrand, these three studies were based on interviews and plant visits to over 160 medium and small private sector business and a series of working sessions with the major commercial banks - probably one of the most searching inquiries of the private sector yet conducted in Africa. See Annex 2, Technical Analysis, for a summary of the findings and conclusions contained in these three reports.

The Private Sector Support Program will continue and expand the policy dialogue initiated by USAID with the GOZ under the AEPRP-funded Structural Adjustment Support Grant (660-0121). This grant supported a program of reform including:

- A long-term program of tariff-rate rationalization to promote efficient import substitution;
- Reduction of export formalities;
- Continued implementation of exchange rate, import licensing, fuel pricing, and price liberalization reforms initiated since 1983.

After program authorization in September, 1986, USAID participated in policy dialogue with the GOZ regarding exchange rates and fuel prices, which continued until steps taken at the end of March, 1987 permitted USAID to release the first tranche of funding. Dialogue has continued, especially concerning fuels. USAID has furnished the GOZ and other donors such as the IMF and the World Bank information and original analysis of fuel pricing and taxation, particularly with respect to eastern Zaire where USAID is financing fuel imports under its Commodity Imports Program for agricultural marketing. Revision of the fuel price structure is expected in the near future.

In the financial sector, USAID has been engaged in discussions with the Bank of Zaire concerning the reserve requirement applied to Counterpart Fund (CPF) accounts since June, 1987, after the CPF was transferred from a non-interest bearing account at the Central Bank to an interest bearing account at a commercial bank. At that time, the Bank of Zaire raised the reserve requirement on this account to 100 percent. This dialogue has become a multilateral discussion led on the donors' side by USAID and Canadian Cooperation and including other donors. Dialogue has lead to an initial reduction in the CPF reserve requirement to 70 percent. Some of the subjects raised will continue to be discussed under the Private Sector Support Program using the lines of communication already developed with the Bank of Zaire's Managing Director, the Director of Studies, the Director of Credit, and the Director of Banking Supervision.

The mission's successful Commodity Import Program has resulted in close operational working relationships with commercial banks operating in Zaire. All current participating commercial banks are seriously interested in continued involvement in the PSSP. The CIP has also directly involved the mission in relationships with U.S. based banks in import-export documentary credits operated under Letters of Commitment. These banking relationships and the proven working policies and procedures will continue in force under the CIP component of the PSSP.

## 2. DISBURSEMENT SCHEDULE AND FINANCIAL FLOW ESTIMATES

The PSSP finances a $40 million grant from AID to restructure the Zairian commercial banking sector to enable it to support productive investment by medium and smaller-scale enterprises. Approximately $35 million of this amount will be utilized over a three year period for specified essential private sector imports utilizing credit arranged by participating local commercial banks in a Commodity Import Program format. The balance of $5 million will be employed over a five year LOP for essential program management, technical assistance, audit fees, and special studies and evaluations. No dollar funds will be made directly available to, or pass through, any GOZ organizations, including the Bank of Zaire.

The Mission plans to obligate $16,000,000 in the second quarter of FY 1989 ($14,000,000 for the CIP and $2,000,000 for technical assistance), $16,000,000 in FY 1990, $7,000,000 in FY 1991, and $1,000,000 in FY 1992. In addition, the GOZ will contribute the local currency equivalent of $15 million for deposit to the CPF. These local currency contributions will come from funds currently being generated by other U.S. financed CIPs and PL 480 programs.

The PSSP will generate the local currency equivalent of $35.0 million collected by participating commercial banks from repayments of private sector businesses qualifying for the dollar foreign exchange commodity import program. These recoveries will be paid directly into the separate special account established for this program via a private local Fiduciary Bank under contract to USAID.

The local currency counterpart fund generations from the PSSP's dollar commodity import program and the GOZ contributions will be jointly programmed under normal Mission CPF programming and budgeting policies and procedures. Earmarks will be made annually or as required for the PSSP's Local Currency Lending Program (LCLP) and for incentive programs currently under study for encouraging the banking sector to mobilize local currency deposits and expand local currency lending to the private sector utilizing its own internally generated resources.

Reflows from local currency loans will return to the general U.S./Zaire CPF. Although further CPF contributions to the PSSP may be made in future years, reflows are not specifically earmarked for the PSSP.

See Exhibit 2.1, Summary Cost Estimate and Financial Plan, which follows this page for a summary of the source and application of funds.

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EXHIBIT 2.1

SUMMARY COST ESTIMATE AND FINANCIAL PLAN

- PRIVATE SECTOR SUPPORT PROGRAM -

($000)

| SOURCE<br>APPLICATION | METHOD OF FINANCING | USAID $ | GOZ* $ | TOTAL |
|---|---|---|---|---|
| 1. COMMODITY IMPORT ($) LENDING (Z) | BANK L/COM DIRECT L/COM | $35,000 | --- | $35,000 |
| 2. LOCAL CURRENCY LENDING | BANK LOAN | --- | 13,500 | 13,500 |
| 3. PROGRAM MANAGEMENT 15 P/Y PSC PLUS LOCAL HIRE STAFF | DIRECT PAY | 3,400 | 500 | 3,900 |
| 4. TA - POLICY REFORM/ MONITORING/STUDIES 70 P/M | DIRECT PAY | 950 | 500 | 1,450 |
| 5. FIDUCIARY BANK SERVICES | DIRECT PAY | 250 | 500 | 750 |
| 6. AUDITS | DIRECT PAY | 200 | - | 200 |
| 7. EVALUATION | DIRECT PAY | 200 | - | 200 |
| TOTAL | | $40,000 | $15,000 | $55,000 |

* Equivalent in Local Currency

### 2.1 Methods of Financing

Dollars will be disbursed directly to exporters by U.S. banks selected by project management. These banks will be reimbursed by the United States Government under Bank Letters of Commitment. Alternatively, Direct Letters of Commitment will be issued by USAID directly to suppliers/exporters in developing countries (as appropriate). The procedures, approval authorities, communication channels and reporting and control mechanisms for establishing Letters of Credit and insuring payments to suppliers are currently in place and working successfully as part of current Mission CIP programs. Consult Annex 7, Implementation Procedures for Private Sector Financing for further details.

Personal Services Contracts and institutional AID contracts will be used to procure technical assistance and consulting, fiduciary and audit services. Normal competitive bidding practices will be followed in qualifying, awarding and contracting.

### 2.2 Financial Accounting Mechanisms

Disbursement, recovery and accounting of local currency counterpart funds used for local currency lending or bank incentive programs will be based on CPF allocations to the PSSP for such activities as authorized by the Mission as part of normal CPF budgeting and approval policies and procedures. The designated Fiduciary Bank will maintain the Counterpart Fund account. The Fiduciary Bank will be responsible for disbursement, collection, accounting and reporting for these funds on the basis of USAID policies, procedures and approval authorities and under terms of specific contractual agreements between the bank and USAID.

Personal services contracts will be negotiated with individuals selected for the PSSP Project Management Unit. The USAID Controller will arrange direct payment. Short term technical assistance obtained from institutional contractors will be paid in the same manner.

Contracts for specific services or consulting assignments - impact studies, policy surveys, program research and analysis, audits, monitoring, evaluation and fiduciary bank services - will be competitively tendered against specific work scopes, schedules and performance criteria prepared by the PSSP Project Management Unit. Payments will be made as appropriate from dollar or local currency funds by the USAID Controller against invoices approved by the Project Design and Operations Office and the Controller.

Exhibit 2.2, Projections Of Expenditures By Fiscal Year, which follows, shows forecast expenditures by year and by major expenditure category.

More detailed financial tables are found in Annex 8, Detailed Budget and Cost Estimates.

EXHIBIT 2.2

## PROJECTIONS OF EXPENDITURES BY FISCAL YEAR

- PRIVATE SECTOR SUPPORT PROGRAM -

TABLE I

($000)

| EXPENDITURES | YR 1 | YR 2 | YR 3 | YR 4 | YR 5 | TOTAL |
|---|---|---|---|---|---|---|
| USAID | | | | | | |
| 1. CIP | $14,000 | $15,000 | $ 6,000 | - | - | $35,000 |
| 2. PROGRAM MANAGEMENT | 600 | 650 | 660 | 740 | 750 | 3,400 |
| 3. TECH ASSIST/STUDIES | 185 | 245 | 205 | 175 | 140 | 950 |
| 4. FIDUCIARY BANK | 50 | 50 | 50 | 50 | 50 | 250 |
| 5. AUDITS | 40 | 40 | 40 | 40 | 40 | 200 |
| 6. EVALUATIONS | - | 50 | 75 | - | 75 | 200 |
| SUB TOTAL USAID | $14,875 | $16,035 | $ 7,030 | $ 1,005 | $ 1,055 | $40,000 |
| GOZ* | | | | | | |
| 1. LOCAL CURRENCY LENDING | $ 1,500 | $ 3,000 | $ 3,500 | $ 4,000 | $ 1,500 | $13,500 |
| 2. PROGRAM MANAGEMENT | 100 | 100 | 100 | 100 | 100 | 500 |
| 3. TECH ASSIST/STUDIES | 100 | 100 | 100 | 100 | 100 | 500 |
| 4. FIDUCIARY BANK | 100 | 100 | 100 | 100 | 100 | 500 |
| SUB TOTAL GOZ | $ 1,800 | $ 3,300 | $ 3,800 | $ 4,300 | $ 1,800 | $15,000 |
| TOTAL PSSP | $16,675 | $19,335 | $10,830 | $ 5,305 | $ 2,855 | $55,000 |

*DOLLAR EQUIVALENT

## 3. IMPLEMENTATION

The implementation plan described below address the four key implementation elements: program management, program planning and scheduling, financial management, and program reporting. Reference should be made to important related annexes to this PP, in particular Annex 1, The Logframe Matrix, Annex 2, Technical Analysis, Annex 5, Administrative Analysis, and Annex 7, Implementation Procedures for Private Sector Financing.

### 3.1 Program Participants Responsibilities And Relationships

Participants in this process include the GOZ, USAID, private commercial and fiduciary banks, private consulting and audit firms, and private sector businesses. Exhibit 3.1, Basic Program Objectives and Participating Organizations, portrays these basic PSSP objectives and relationships.

- Donor/Grantee Policy Dialogue And The Role Of USAID Management

  The PSSP grant agreement between the GOZ and AID will specify continuing high level policy dialogue and policy reform reviews over the life of the program. Responsibilities for these activities are placed with senior Mission management at the Director level and GOZ designated senior officials at ministerial and central bank levels. (Refer to Section 6, Conditions and Covenants, for discussion of the GOZ/AID consultative process envisioned.)

- Program Management And Related Advisory And Support Services

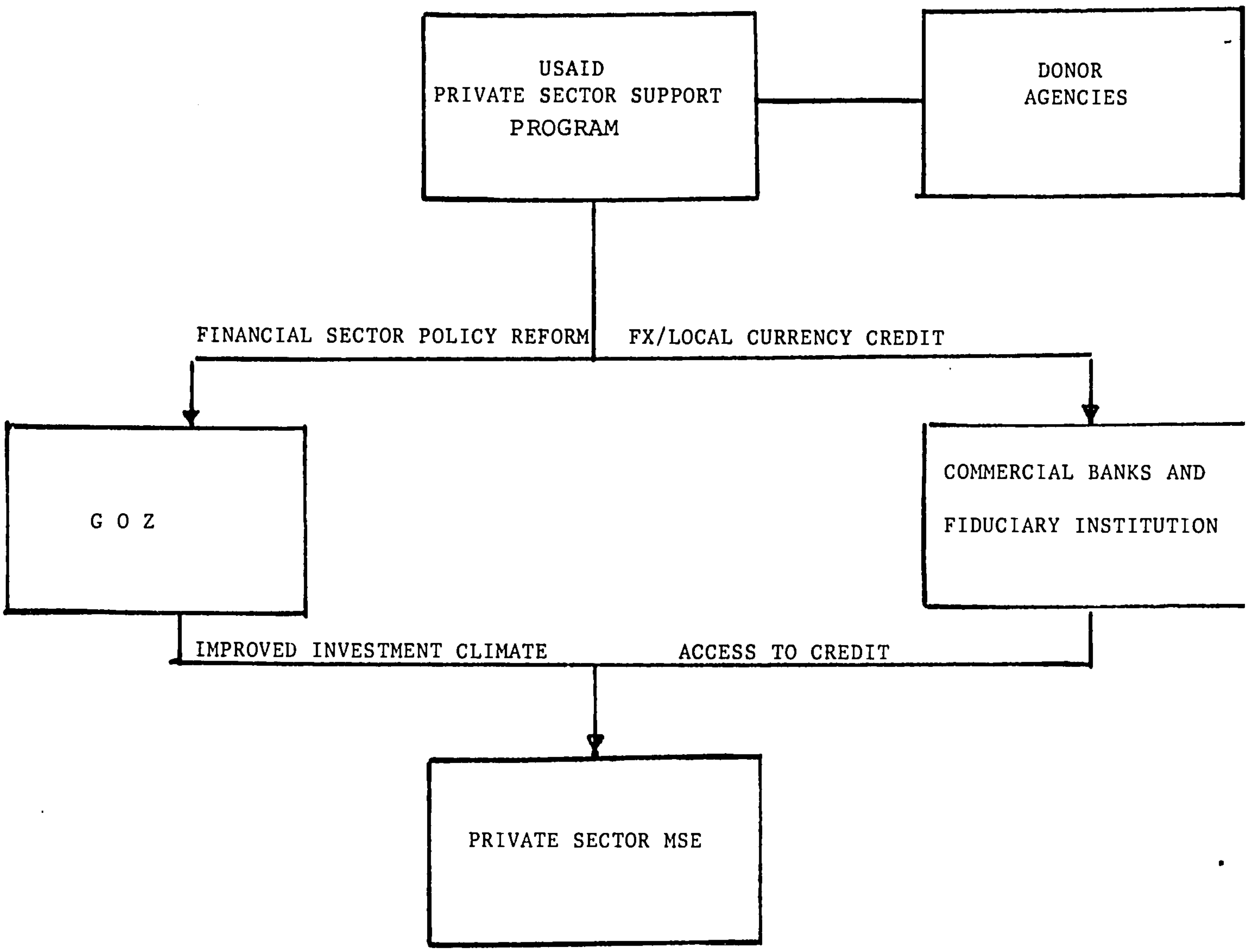
  The PSSP will be under the direct supervision of the Mission's PDO Division Chief. He will be responsible for providing policy guidance and direction to the PSSP Project Manager, who in turn will supervise a Financial Sector Economist, a Program Economist, and the CIP management unit.

  The PDO Division Chief will receive advice and assistance from the Mission's existing Private Sector Advisory Committee augmented by the Controller and Legal Advisor. (Refer to Annex 5, Administrative Analysis.)

EXHIBIT 3.1

BASIC PROGRAM OBJECTIVES AND PARTICIPATING ORGANIZATIONS

- PRIVATE SECTOR SUPPORT PROGRAM -



The PSSP Program Management Unit will be assisted by consulting, advisory and audit services provided by established consultancy and audit firms selected on the basis of competitive bidding against detailed scopes of work.

- Participating Local Commercial Banks

  Participating commercial banks will be responsible for the purchase of PSSP dollar foreign exchange on behalf of private sector MSEs for the import of designated critical commodities. They will also be the vehicle for the counterpart fund local currency lending program.

- Fiduciary Bank

  A fiduciary bank will be selected to provide a range of financial, coordinating, monitoring and reporting functions for the PSSP special account and Local Currency Lending Program.

- Private Sector MSE Borrowers

  Private sector borrowers who meet PSSP specifications and qualify under commodity import criteria will work directly with and through their participating commercial banks in accessing foreign exchange and local currency credit. Borrower-lender relationships will be agreed between the two parties. Participating banks bear full responsibility for credit decisions, collections and risks and will be held responsible for all repayments to the counterpart fund regardless of repayment status of the borrower.

Exhibit 3.2, Project Structure, depicts the relationships and responsibilities described above.

## 3.2 Pre-Implementation Planning

Four specific assignments were identified and assigned to outside consultants for completion during the PP design phase.

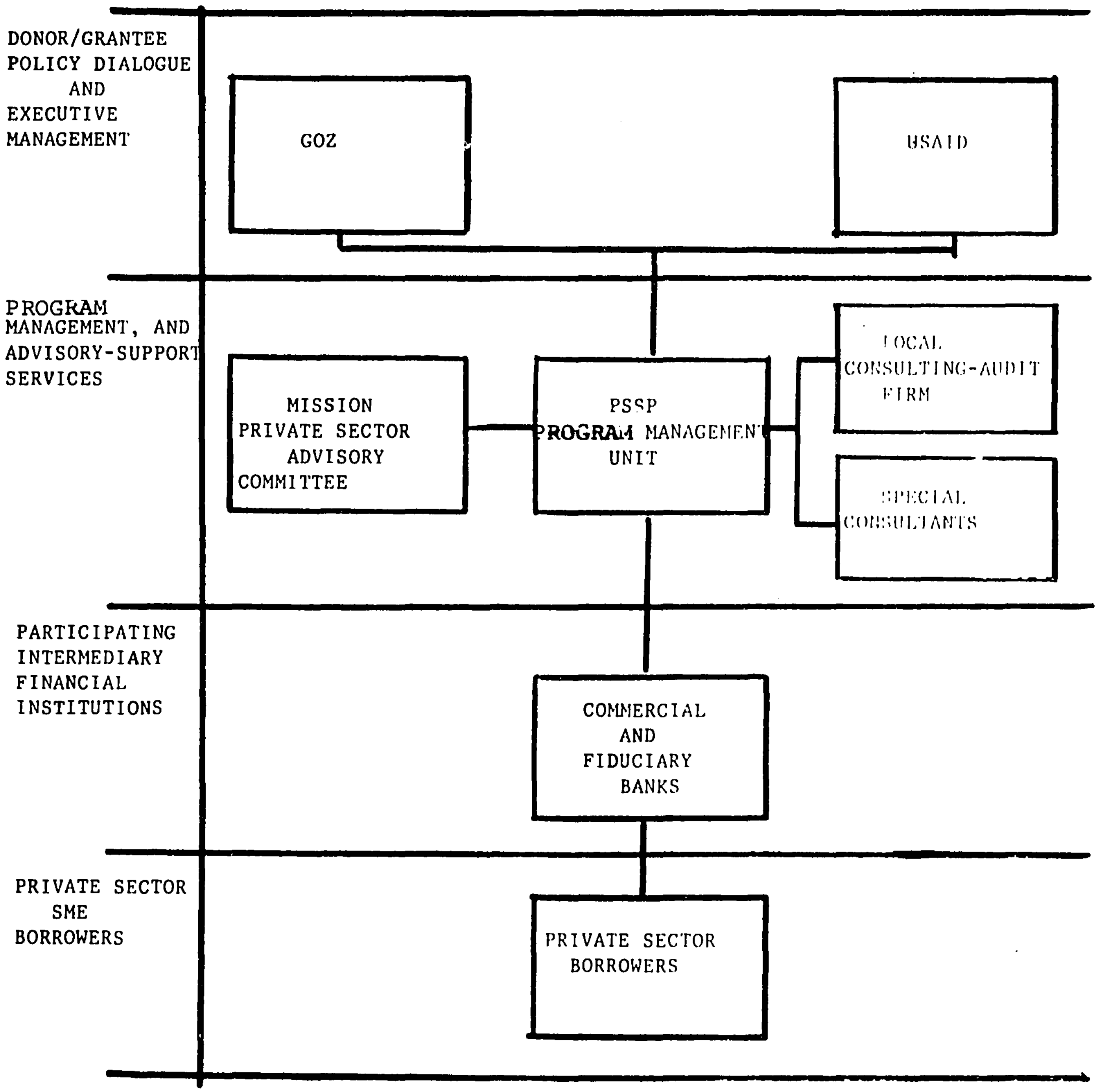
- Specification of PSSP management information, control and reporting system requirements;

- Conduct of a social soundness analysis including women in development issues;

EXHIBIT 3.2

PROGRAM STRUCTURE

PRIVATE SECTOR SUPPORT PROGRAM



- o Consolidation of private sector surveys, identification of priority private sector borrower targets, and assessment of the size of the private sector borrower market and its absorption capacity and rate;

- o Update on the Zairian banking and finance system and its key participants.

There are a number of AID specific requirements which are necessary prior to full program start up.

- o PAAD approved by AID/W.

- o PROAG signed between USAID/GOZ.

- o Contracting for technical services.

- o PIL(s) signed between USAID/GOZ including basic implementation PIL with Commodity Procurement Instructions (CPI), and compliance with CPs and covenants.

- o Financing requests signed between USAID/GOZ

- o Bank Letters of Commitment issued by AID/W

- o Bank circular issued by Central Bank/GOZ, including protocol of understanding between commercial banks and the fiduciary bank.

Refer to Exhibit 3.3, <u>Implementation Planning Actions</u>, which follows this page, for a summary of these and other implementation start-up actions.

Refer to Exhibit 3.3, <u>Implementation Planning Actions</u>, which follows this page, for a summary of these tasks.

### 3.3 <u>Program Monitoring And Evaluation Planning</u>

Consult section 4, <u>Monitoring Plan</u>, and section 7, <u>Evaluation</u>, for discussions of monitoring and evaluation activities planned under the PSSP.



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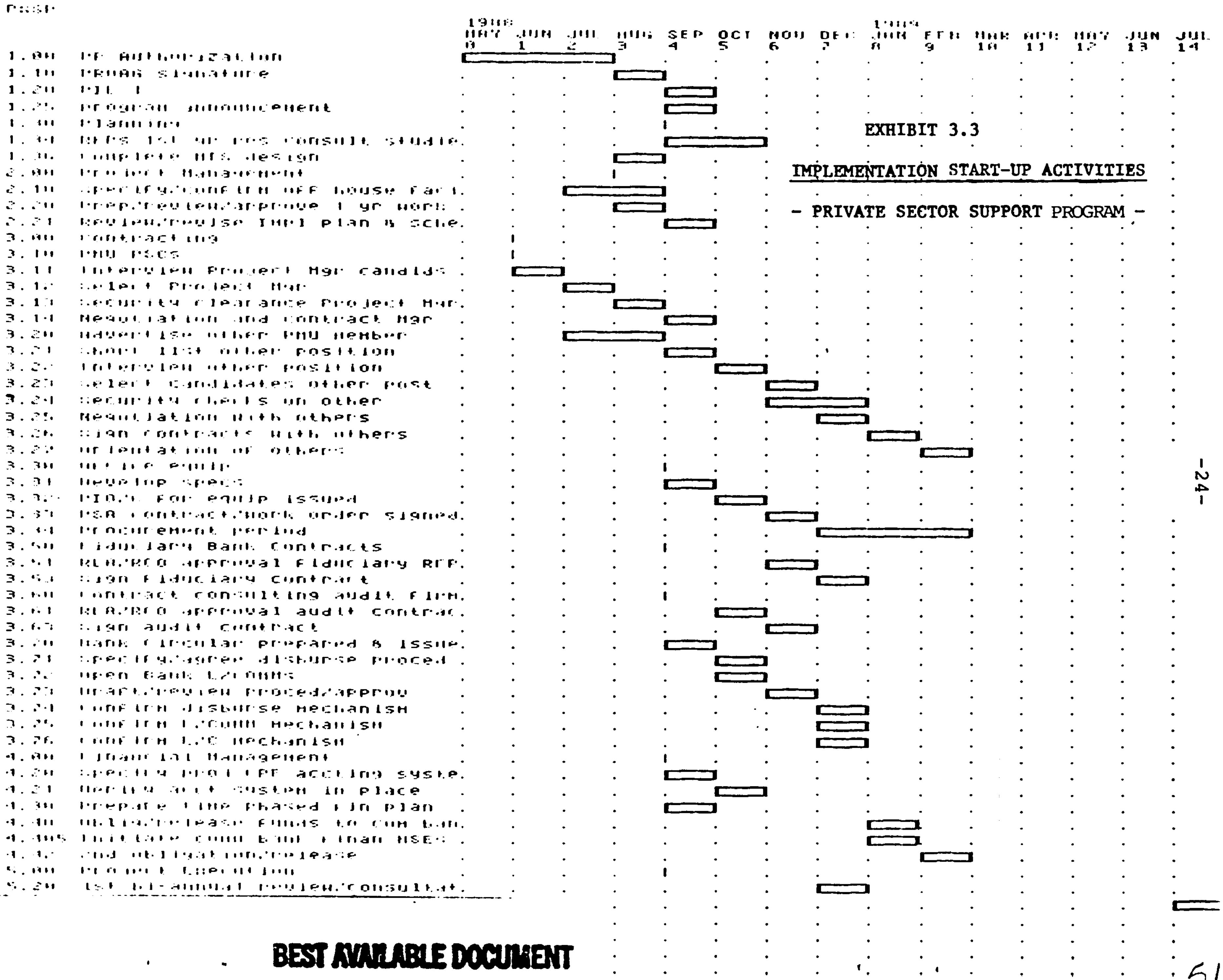
**EXHIBIT 3.3**

**IMPLEMENTATION START-UP ACTIVITIES**

**- PRIVATE SECTOR SUPPORT PROGRAM -**

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### 3.4 Implementation Of Research, Impact Studies And Human Resources Development Support

Refer to Annex 6, Proposed Research, Evaluation and Impact Studies and Human Resources Development, for summaries, budget estimates, and implementation of the proposed tasks.

### 3.5 Operational Post-Program Agreement Implementation Plan

Implementation actions required during the operational phase of the PSSP have their origin in the pre-implementation and start-up actions described above. The operational implementation plan should, therefore, be viewed as a logical continuation of pre-implementation planning described in 3.2 above.

The nature of the PSSP and mission guidelines have structured the implementation plan as follows:

- The CIP nature of the program places much of the responsibility for non-policy implementation actions outside formal GOZ channels and actions.

- The private sector focus of PSSP emphasizes use of normal international commercial and banking channels and networks for foreign exchange acquisition and flows, and export-import activities.

- The importance of the policy dialogue and conditionalities objectives of the PSSP places heavy emphasis on mission concentration on policy reform activities as opposed to more routine program management tasks.

- Mission workloads apart from the PSSP dictated maximum delegation of routine implementation tasks to a Program Management Unit able to operate on a semi-independent basis, while having access to consultants for special studies and program monitoring, impact and evaluation responsibilities.

- The existence of an effective in-place CIP program with its own dedicated staffing provided an internal "on-going business" capability for absorbing implementation responsibilities related to the commodity import aspects of the PSSP.

### 3.6 Implementation Actions Of A Continuing Nature

No attempt has been made to describe in any detail the many repetitive actions which the PSSP entails. Reference should be made in this regard to Annex 5, Administrative Analysis, Annex 2, Technical Analysis, and Annex 7, Implementation Procedures for Private Sector Financing.

Exhibit 3.4, Major Recurring Implementation Actions Following Project Start-Up Phase, indicates the timing of obligations, releases, GOZ/AID consultations, audits, impact surveys and studies.

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## EXHIBIT 3.4
## MAJOR RECURRING IMPLEMENTATION ACTIONS FOLLOWING PROGRAM START-UP PHASE

| TASK | | 1989 QUARTER | | | | 1990 QUARTER | | | | 1991 QUARTER | | | | 1992 QUARTER | | | | 1993 QUARTER | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 | 1 | 2 | 3 | 4 |
| Prepare Annual Work Plan | | x | | | | x | | | | x | | | | x | | | | x | | | |
| Obligation | | x | | | | x | | | | | | | | | | | | | | | |
| Semi-annual release | | x | | x | | x | | x | | | x | | | | | | | | | | |
| PIR | | | x | | x | | | x | x | | x | | x | | x | | x | | x | | x |
| Bi-annual GOZ/AID Consultation | x | | x | | | | x | | x | | x | | x | | x | | x | | x | | x |
| Annual audit-MSE Financing | | | | | x | | | x | | x | | | | x | | | | | x | | |
| Seminar/conference on fin. sec. issues | | | | | x | | | | | | | | x | | | | | | | | |
| Annual survey of MSE Impact | | | | x | | | | | x | | | x | | | | | x | | | x | |
| Economic, finance, banking studies | | | | | x | | | | x | | | | x | | | | x | | | | x |
| Program evaluations | | | | | | | | x | | | | | x | | | | | | | x | |

## 4. MONITORING PLAN

The monitoring plan designed into the PSSP has two major objectives:

- o Track performance against PSSP objectives, plans and schedules; identify problem areas; and recommend appropriate corrective actions.
- o Ensure that terms and conditions in all contracts with GOZ, participating banks and fiduciary bank and other individual and corporate contractors are met.

The PSSP implementation plan provides for development of management information and control system specification and detailed systems design work utilizing qualified outside information system consultants. The specifications of the system will be found in Annex 5, Administrative Analysis. Detailed systems design work will commence following PP approval.

The management information and control system will specify information and report inputs and outputs and reporting formats for each participant in the PSSP including the Program Management Unit. The system will specify:

- o Data and records required for monitoring, analyses, decision making and downstream evaluations.
- o Procedures, data and report formats and project monitoring methodologies.
- o Responsibilities, content and frequency of monitoring reporting.

The design and installation of the PSSP Program monitoring system will be accomplished in three steps.

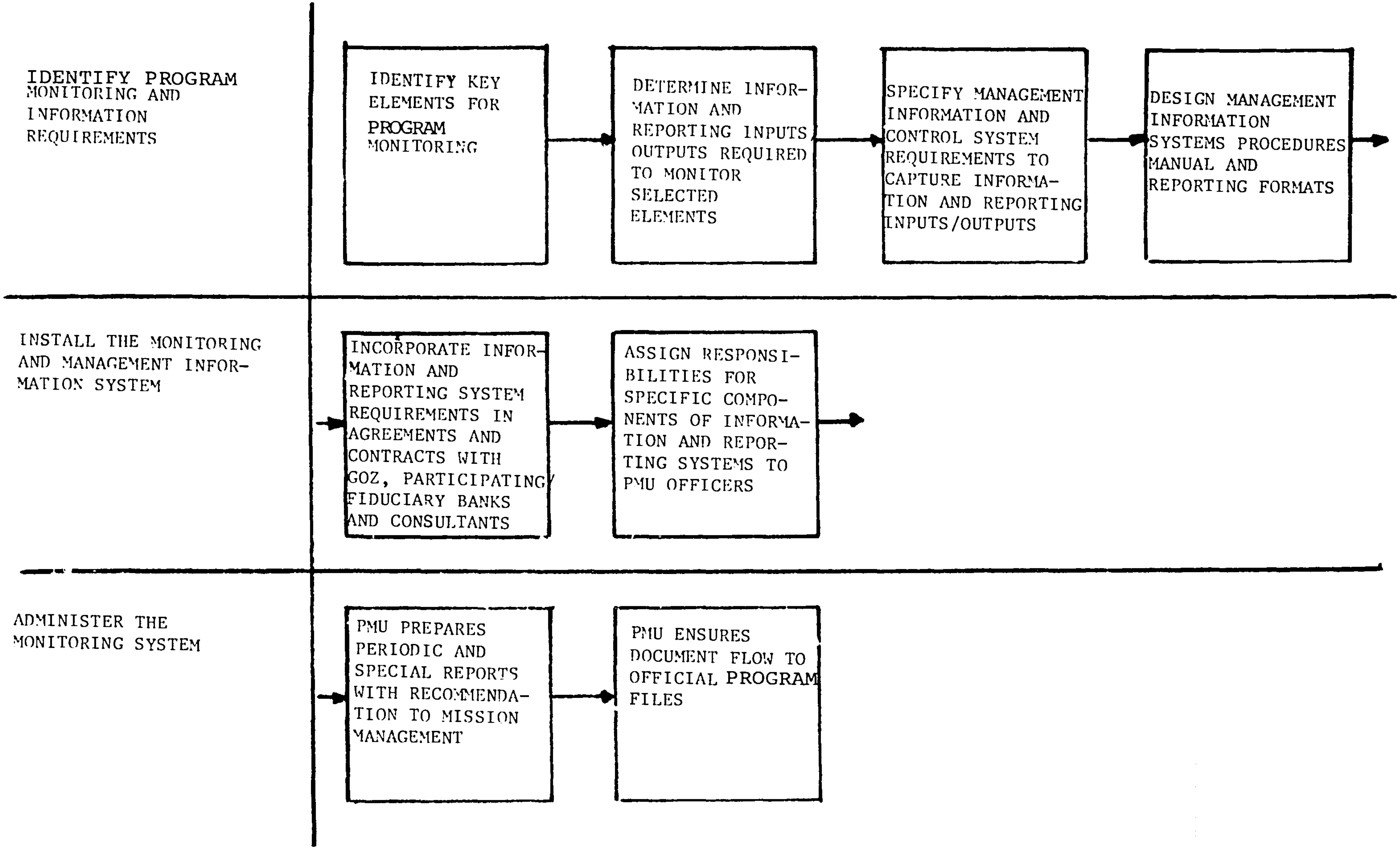
- o Identification of project monitoring and information requirements.
- o Installation of the monitoring and management and information control systems.
- o Administration of the systems.

Exhibit 4.1, Project Monitoring System, summarizes in graphical form the elements included in this three step process.

EXHIBIT 4.1

## PROGRAM MONITORING SYSTEM

PRIVATE SECTOR SUPPORT PROGRAM



A number of key monitoring elements have been identified. The PSSP management information and control system and the structuring of the Program Management Unit address these important monitoring elements.

- Verify GOZ compliance with conditions precedent, conditionalities and covenants.
- Ensure that contracts and agreements are negotiated and signed.
- Monitor compliance with terms and conditions for disbursement and use of foreign exchange.
- Monitor compliance with terms and conditions for disbursement, use and accounting for the local currency lending fund.
- Monitor the source and use of all PSSP funds.
- Evaluate the effectiveness of implementing agents and contractors.
- Evaluate effectiveness of GOZ and donor coordination.
- Assess adequacy of official and project working files.
- Evaluate effectiveness of project reporting.

Exhibit 4.2, Key Monitoring Elements, which follows this page provides further details on the data requirements and sources, and responsibility for system management. Consult Annex 5, Administrative Analysis, for the detailed management information, reporting and control systems specifications for the PSSP.

EXHIBIT 4.2

KEY MONITORING ELEMENTS

PRIVATE SECTOR SUPPORT PROGRAM

| MONITORING ELEMENT | DATA REQUIRED FOR MONITORING | RESPONSIBILITY | PROGRAM INFORMATION SYSTEM SOURCE |
|---|---|---|---|
| 1. VERIFY GOZ COMPLIANCE WITH CONDITIONS PRECEDENT, CONDITIONALITIES AND COVENANTS<br><br>(1) Obtain documentation and legal opinions.<br>(2) Propose extensions and modifications.<br>(3) Alert mission management to non-compliance and recommend action.<br>(4) Confirm conditions precedent met and issue PIL.<br>(5) Oversee compliance with covenants and conditionalities. | PROGRAM CONDITIONS PRECEDENT:<br>o Financial Development Policy Statement.<br>o GOZ request to assist in policy implementation.<br>o Formation of Advisory Consultative Group.<br><br>MACROECONOMIC COVENANTS AND CONDITIONS:<br>o Guarantees for maintenance of critical liberalization policies: budget deficit limitations, price liberalization, market determined interest exchange and fuel rates. | PDO<br>Program Manager<br>Economist<br>(assisted by USAID Prog. Economist)<br>Financial Sector Economist | Compliance monitoring accomplished by continuing policy dialogue and Consultative Group discussions. |

Exhibit 4.3 Continued

| MONITORING ELEMENT | DATA REQUIRED FOR MONITORING | RESPONSIBILITY | PROGRAM INFORMATION SYSTEM SOURCE |
|---|---|---|---|
| | <u>RELEASE OF SECOND TRANCHE:</u><br>o Measures taken re promoting money markets and market determined interest rates.<br>o Incentives established for banks to extend credit to private sector via bank mobilization of larger share of national liquidity.<br><br><u>RELEASE OF SUBSEQUENT TRANCHES:</u><br>o Further measures aimed at promoting more active money market and improving bank incentives to mobilize domestic savings. | | |
| 2. <u>ENSURE CONTRACTS AND AGREEMENTS NEGOTIATED AND SIGNED</u> | <u>PERSONNEL:</u> PSC contracts signed on schedule.<br><u>OFFICE AND HOUSING FACILITIES:</u> Procurement and contracting completed on schedule.<br><u>PARTICIPATING ORGANIZATIONS:</u> Agreements and contracts with participating banks, fiduciaries and consultants signed on schedule. | PROGRAM MANAGER | PMU will follow conformity with implementation schedule working closely with the mission's legal contracts and administrative units. |

Exhibit 4.2 Continued

| MONITORING ELEMENT | DATA REQUIRED FOR MONITORING | RESPONSIBILITY | PROGRAM INFORMATION SYSTEM SOURCE |
|---|---|---|---|
| 3. MONITOR COMPLIANCE WITH TERMS AND CONDITIONS FOR USE OF FOREIGN EXCHANGE | BORROWERS: Specifications and restrictions honored by participating banks. Target groups being reached.<br>IMPORTS: Commodity restrictions observed.<br>SOURCE: Supplier source country restrictions observed. | PROGRAM MANAGER<br>FN Commodity Staff | Program MIS system will assisted by outside auditors will provide control information. See Annex 5, Administrative Analysis. |
| 4. MONITOR COMPLIANCE WITH TERMS AND CONDITIONS FOR LOCAL CURRANCY LENDING PROGRAM | BORROWERS: Specifications and restrictions placed on eligible borrowers observed. Target groups being addressed.<br>USE OF FUNDS: Specifications and restrictions on use of local currency funds observed.<br>REPAYMENT OF LOANS: Loan repayment history and trends reported. | PROGRAM MANAGER | Program MIS systems assisted by outside auditors will provide control information. See Annex5, Special consulting studies also utilized. |

| | | | |
|---|---|---|---|
| 5. MONITOR SOURCE AND USE OF FUNDS | FOREIGN EXCHANGE: Commitment letters in place, credit lines operative, exporters paid, and confirming/paying bank drawing down against commitment letter.<br>GOZ CONTRIBUTIONS: Funds budgeted and released by GOZ as per agreements.<br>LOCAL CURRENCY: Participating banks making local currency payments to counterpart fund for payment for foreign exchange. All transfers in and out of counterpart fund in connection with local currency lending program timely and accurate.<br>PROGRAM RELATED PAYMENTS: All individual and company contractors and suppliers paid on schedule. | PROGRAM MANAGER<br>FN Commodity Staff | Close working relationship with mission controller re project related payments. Periodic audits by outside auditors will be scheduled. |
| 6. EVALUATE EFFECTIVENESS OF IMPLEMENTING AGENTS AND CONTRACTORS | PERSONAL SERVICES CONTRACTORS<br>FIDUCIARY BANK<br>PARTICIPATING BANKS<br>CONSULTANTS AND AUDITORS | PDO<br>PROJECT MANAGER | Periodic evaluation and reporting of performance to mission management with appropriate recommendations. |



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Exhibit 4.2 Continued

| MONITORING ELEMENT | DATA REQUIRED FOR MONITORING | RESPONSIBILITY | PROGRAM INFORMATION SYSTEM SOURCE |
|---|---|---|---|
| 7. EVALUATE EFFECTIVENESS OF PROJECT REPORTING | PROGRAM IMPLEMENTATION STATUS REPORT: Prepared on an accurate and timely basis.<br>ROUTINE AND SPECIAL REPORTS: Participating and fiduciary banks, consultants and auditors meeting all agreed reporting requirements on an accurate and timely basis.<br>EVALUATION OF PROGRAM-MIS SYSTEM: Mid project evaluation of effectiveness of project MIS. | PDO<br>PROGRAM MANAGER | See Section 4, Monitoring Plan, and Annex 5. Supplemented by interviews and audits. |

## 5. SUMMARIES OF PROGRAM ANALYSES

This Section provides summaries of Annexes to the Program Paper. Annex 2, The Technical Analysis, is summarized in Section 5.1, including sections on the Private Sector, the Central Banking System, the Commercial Banks and other financial institutions, major areas of reform, and the PSSP Response to private sector credit needs.

Section 5.2, summarizes Annex 3, The Economic Analysis, and discusses the key liberalization measures made by the GOZ, fiscal performance of the GOZ, the overall economic climate and the goals of the PSSP within the context of financial sector reform measures.

The Social Soundness Analysis, summarized in Section 5.3, describes the target beneficiaries of the Program, the MSEs, and expected spread affects to other Sectors such as consumers, employees and agriculture. Brief discussions of credit and savings in the informal sector and women in the private sector show how the PSSP can better understand and reach USAID's traditional target groups - the poor, women and rural institutions.

Section 5.4, summarizes Annex 5, The Administrative Analysis, and examines the scope, adequacy and cost effectiveness of the overall management and administration of the PSSP, including operations and control requirements, administrative structure and responsibilities of participants, the structure of the PSSP Program Management Unit (PMU), the management information and control system, the functioning of the currently installed CIP Program, and its cost effectiveness.

### 5.1 TECHNICAL ANALYSIS SUMMARY

This section summarizes the major needs of a representative sample of medium and small private sector businesses in Zaire. Economic, policy and operational constraints of the finance and banking systems in meeting the critical credit needs of these MSE companies are reviewed. PSSP policy reform and program elements for assisting the banking system to respond to MSE credit requirements is described. For detailed discussion of these issues refer to Annex 2, Technical Analysis and Annex 3, Economic Analysis.

(1) Private Sector Overview

Manufacturing as a percent of GNP declined 19 percent over the period 1970-1984. The textile and clothing, wood products, food processing and leather shoe segments were down 40 percent, 37 percent, 20 percent and 57 percent respectively during the same period. The only growth was agriculture, infastructure and mining segments traditionally supported by donor assistance and multilateral lending agencies.

Three major groundbreaking surveys of medium and small private sector businesses were undertaken by Coopers and Lybrand during 1987-88. These studies were carried out in the important urban centers of Kinshasa, Lubumbashi, Likasi and Kolwezi, as well as broadly in the regions of Bandundu and Shaba, the areas of AID program concentration. The surveys included a 130 company sample of smaller companies in the range of 10-100 employees and one million Zaires ir assets; and a 37 company sample of medium sized companies

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with average employment of 250 and average sales of $2,760,000.

The small company survey resulted in a number of conclusions:

- Companies in the 10-30 employee range are in reality "cottage industry" companies. Above that size they begin to take on the characteristics of organized business activities.

- The financing of productive imports - both foreign and exchange and local currency - is a major and chronic problem.

- The financing of spare parts and access to medium and long term credit for rehabilitation and modernization remain an equally important problem.

- Currency depreciation has virtually shut off credit extensions which in turn in further restricts market expansion.

The medium sized company survey confirmed a lack of business confidence in Zaire's currently depressed economy, and reinforced the view that access to foreign exchange and local currency credit are major obstacles to private sector business growth. The current credit squeeze is effectively reducing company utilization which in turn is driving up unit costs and forcing businesses to lose sales.

- Capacity utilization averages 49 percent.

- A major reason for low utilization is lack of sufficient raw materials: again, limited and expensive access to foreign exchange for imported inputs, and unreliability or unavailability of local imports.

(2) The Central Banking System

The Banque du Zaire (BDZ) is responsible for classic central banking functions: regulation of the banking system, establishment of credit and monetary policies, issuance of money, and management of multinational reserves. The continuing liquidity crisis has also forced the BDZ into the role of "lender of first resort" - financing both the GOZ deficit and providing financial resources to the commercial banking system.

The central banking system exercises policy control through several credit and monetary instruments:

- Monetary Supply: There has been a rapid growth in money supply over the past five years. The banking system has, however, failed to mobilize these resources, and the informal sector has shown relative strength in retaining liquidity - one out of two zaires issued by the BDZ remains outside the banking system. The failure of the commercial banks to mobilize deposits and the relative strength of the informal sector to hold currency has made it difficult for the Central Bank to pursue an efficient monetary policy and to fight inflation. Since the BDZ acts as "lender of first resort" in support of the commercial banking system, banks have no incentive to mobilize resources. One result is permanent structural inflation.

- Bank Credit Ceilings: The Central Bank has set relatively low credit ceilings to limit overall bank lending. Banks currently have fully utilized these ceilings, and qualified borrowers must wait their turn.

- Bank Reserve Requirements: Reserve requirements currently stand at 50 percent of a bank's combined deposits, current account balances of less than six months, letter of credit provisions and 100 percent of counterpart funds. These reserve balances are not remunerated. Since banks can fund themselves at the BDZ money market window at the rate of 35 percent, the result is that banks are currently borrowing more from this window than the amount held by the Central Bank in bank reserve deposits.

- Rediscount Facilities The rediscount for short term discounting of commercial paper is 37 percent. Since the money market window is cheaper, this facility is not used.

- Interest Rates Most interest rates are now free to fluctuate. Commercial bank lending rates of 32-46 percent in 1987 have been negative due to high inflation rates approaching 100 percent. Banks state that public and political pressure would be intense if rates moved higher. Since commercial banks earn high fees on letters of credit, guarantees and foreign exchange transactions, they are willing to absorb possible losses associated with local currency lending. Deposit rates have remained rigid: current account deposits earn 5 percent, while time deposits range from 3.25 to 33 percent.

- Treasury Bills A new series of Treasury Bills were issued in 1984 in an attempt to reduce liquidity held by the public and finance the GOZ deficit. T-bills carry one to six-month maturities and pay tax free interest rates ranging from 34 to 45 percent. Commercial banks are not allowed to purchase these T-bills and do not provide a secondary market in these securities.

(3) The Commercial Banking System

There are nine commercial banks in Zaire. Three of these banks control 75 percent of commercial banking assets. The top two banks, BCZ, and UZB, are privately owned branches of major European banks. The banks preference for short term lending and fee income services is due to several underlying factors.

- Lack Of Long Term Resources Banks hold primarily short term demand deposits and avoid mismatching short term resources with medium or long term credits.

- High Inflation Rates Negative interest rates resulting from high inflation discourages any form of medium and long term lending.

- Lucrative Non-Fund Business While banks may be essentially breaking even in their lending activities their real profits come

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from fee income - recycling foreign exchange that comes into the country. Rates for these non-fund services are high and this type of business is very profitable.

- Lack Of Branch Networks Zaire appears to be under-banked in relation to its size, population and economic potential. The nine commercial banks in Zaire have 113 branches nationwide, with 65 percent located in Kinshasa and 13 percent in Shaba.

While the commercial banking system is undercapitalized in terms of internationally accepted measures, the fact that all the branches of foreign banks operating in Zaire have access to the strong capital bases of their important foreign parents makes such comparisons artificial. The private commercial banks are generally considered sound and operationally effective.

(4) The Development Banks

There are two development banks in Zaire: SOFIDE and the BCA.

- Societe Financiere de Development (SOFIDE): SOFIDE is a classic development bank established in 1970 with 40 percent GOZ participation and 40 percent from international institutions and local private individuals. Its funding comes almost exclusively from the World Bank and other international institutions. Since foreign exchange risks are assumed by the borrower account, high inflation has caused high levels of unpaid loans.

- Banque de Credit Agricole (BCA): BCA is both a development and a commercial bank and is the only specialized agricultural bank in Zaire. Efforts are underway to increase its capital base and expand its branch operations.

(5) Non-Bank Financial Institutions

The non-bank financial sector comprises the state owned insurance monopoly, a public savings institution, the social security fund and a postal savings unit. They are GOZ owned, poorly managed, undercapitalized and overstaffed. They could play an important role in resource mobilization, but all require major restructuring.

There are a number of informal non-bank financial institutions operated by the private community and religious groups. The most important are the COOPECS which are a form of cooperative credit unions. They have successfully mobilized resources equal to 7 percent of commercial bank deposits.

(6) Major Areas of Reform

Reform in the finance and banking sector is a continuing process under close review by the GOZ, the World Bank and the IMF. A number of important reform measures have already been taken such as the introduction of a unified accounting system for banks, phasing out of turnover tax on interest rates, a new law for the COOPECs, liberalization of interest rates, minimum lending volumes for agricultural loans, and others. Major additional long term reforms are needed, however, to ensure effective resource mobilization and allocation to productive private sector enterprise.

- GOZ Budgetary Deficit: The budgetary deficit remains the most serious monetary policy reform issue. This deficit must be brought under control and means found to finance government operations by public borrowings.

- Credit Ceilings And Reserve Requirements: In coordination with resolution of deficit financing problems the "mechanical" methods of controlling money supply such as imposition of credit ceilings and reserve requirements should give way to improved policy tools for controlling the money supply.

- Treasury Bills: These instruments need to play a major role in financing GOZ budgets and soaking up liquidity. Medium and long term maturities plus creation of a commercial bank secondary market for these securities is required.

(7) The PSSP Response To Private Sector Credit Needs

The PSSP has two underlying objectives: to meet critically important private sector needs for foreign exchange and local currency credit and to secure finance and banking system policy reforms. The approach to private sector credit needs is discussed below. The section which follows, 5.2, Economic Analysis Summary, covers the PSSP's policy reform agenda.

- Increase Private Sector MSE Access To Foreign Exchange For Essential Imports: The PSSP will make foreign exchange available to private sector importers through participating private commercial banks. The PSSP will assume foreign exchange risks. A Commodity Import Program (CIP) approach currently in operation will be employed. Importers will request a foreign exchange allocation from a participating bank for commodities specified in the AID Commodity Eligibility Listing. The bank will evaluate the importer's credit risk, establish credit terms and pass the request to USAID for verification of company and import eligibility under the PSSP.

  The participating bank, upon receipt of USAID approval, will open a letter of credit and import license, and establish the borrower's repayment terms to the PSSP special account.

  The import letter of credit opened by the local participating bank will be forwarded to a U.S.-based bank for advice and negotiation. This U.S. bank will pay the exporter on receipt of documents, and be reimbursed on the basis of a bank letter of commitment.

  Annex 7, Implementation Procedures for Private Sector Financing, should be consulted for further information on eligible banks and MSEs.

- Provide Local Currency Loans To Target MSEs: Local currency generations from the PSSP deposited in the PSSP special account will be made available for on-lending to target MSEs for specified purposes. The Mission will determine the local currency amounts to be utilized for the PSSP lending program as part of normal planning and budgeting for the use of Counterpart Fund generations from all sources. A revolving fund approach will not be employed.

Short-medium term credit of up to one year will be provided to participating bank-qualified borrowers for the purchase of locally available raw materials, spare parts, equipment and machinery.

Local borrowers will pay market interest rates to the CPF guaranteed by the participating bank. Discussions with the IMF have lead to IMF agreement to allow for PSSP local currency lending when establishing credit ceilings with the GOZ. The bank, under this approach, will generate, manage and account for the loan, make interest and principal payments to the CPF, and bear full credit risks in the event of borrower non-payment. A local fiduciary bank mandated by USAID will monitor this program.

Annex 7, Implementation Procedures for Private Sector Financing, contains further details on the local currency lending program.

## 5.2 ECONOMIC ANALYSIS SUMMARY

### (1) Introduction

This section summarizes past and current macroeconomic developments in the Zairian economy and indicates the objectives of the PSSP in financing private enterprises and in facilitating financial sector reform. For detailed discussion of these issues and presentation of economic indicators over time, refer to Annex 3, Economic Analysis, and Annex 2, Technical Analysis, and Section 6, Conditions and Covenants.

### (2) Macroeconomic Overview

Before 1974, the GOZ's economic policy emphasized heavy public-sector investments, nationalization, and high tariff protection. Since the drop in copper prices in 1974 revealed the weaknesses of those policies, the GOZ has adopted a wide range of reforms which have gradually put in place a liberal private-sector oriented economic environment. The key reforms have been:

- Retrocession of Zairianized and nationalized enterprises to private owners, starting in 1976.
- Virtual elimination of agricultural marketing parastatals in 1978.
- Liberalization of interest rates and agricultural and industrial prices in 1981-83 (agricultural interest rates in 1987).
- Liberalization of the exchange rate and import/export transactions in 1983.
- A program of progressive reduction of effective rates of tariff protection starting in 1986.

This program of liberalization is continuing in 1987-88, notably with increased emphasis on privatization of parastatals, reform of parastatal management, and increased private competition in markets which have been parastatal monopolies.

Available figures on GDP indicates that liberalization has arrested the decline in total production between 1974 and 1982 and encouraged moderate growth since 1983. At the same time, however, economic performance has been severely handicapped by the loss of foreign exchange revenues due to further deterioration in the terms of trade since 1974, and to the burden of servicing external debt, contracted almost entirely in or before 1974.

The fiscal impact of the balance of payments crisis has been severe. The GOZ has been successful in dealing with the budgetary crisis mainly in years when balance of payments problems have been relatively manageable, as in 1984 and 1985. Overall, however, fiscal performance has not been satisfactory. While civil service salaries have been reduced to levels that severely compromise the quality of public administration and public services have been drastically cut back, unwise and even unaccounted for public expenditures continue. Tax collection is weak.

As a result of continued high fiscal deficits, the growth rate of the money supply has followed a generally rising trend since as far back as 1971, leading to accelerating inflation and depreciation of the currency, which have mitigated the favorable effect of liberalization on the business climate. Efforts to clamp down on monetary expansion, in the absence of adequate budgetary control, have mainly succeeded in repressing the formal financial system, reducing the mobilization of savings and the availability of credit to the private sector.

(3) PSSP Assistance To MSEs And Financial Sector

The Private Sector Support Program (PSSP) responds to the priority problems of the private business sector as identified by consultants and by the private sector itself: lack of foreign-exchange and local currency financing for efficient import substitution and growth of exports. Continuation of a market-based exchange rate, liberal import and export policies, and progress on tariff-rate reform are therefore critical assumptions underlying the program. Also, improved budgetary control is needed to make structural reforms in the financial sector feasible and to enhance their impact on the private sector. Thus, improved fiscal performance is a second critical assumption.

Within this framework, the PSSP will support the private sector directly through financing imports of working materials and investment goods and through financing local costs. The assistance thus provided will support more productive investment by MSES as well as leading to restructuring of the financial sector.

The objectives of financial sector adjustment are to increase resource mobilization and to improve the efficiency of resource allocation. The key elements of the adjustment program are increases in official interest rates in real terms, institutional development of the money market, strengthened supervision of commercial banking, restructuring of public sector financial institutions, and reform in monetary policy to increase the incentives for mobilization of domestic financial resources by formal financial institutions. The PSSP will support this sectoral restructuring effort by financing studies and monitoring, as well as with conditionality on the release of import financing. For discussion of the specific conditionality, see Section 6, Conditions and Covenant.

(4) Interest Rates for Private Sector Financing

At regular consultations between AID and the GOZ, program authorities will set the interest rate on program funds lent to the program private sector. The rate of interest will at least equal the prevailing rate of interest charged by commercial banks for short-term loans and will take into consideration projections of future inflation. Interest will accrue periodically to the outstanding balance of each loan and will be compound interest. The program may offer borrowers the option of capitalization of interest in early payments, to be reimbursed in later payments, in order to take account of the effects of inflation when multiple payments are called for in the loan agreement.

## 5.3 SOCIAL SOUNDNESS ANALYSIS SUMMARY

### (1) Introduction

This analysis describes the target MSE beneficiaries of the PSSP and looks at major socio-economic factors which affect their functioning. It examines the role of MSEs in urban life and the links between MSEs and non-target beneficiaries, including brief discussions of credit and savings institutions and the role of women in the private sector. Detailed information on the overall socio-economic situation, the role of women and informal credit and savings associations can be found in Annex 4, Social Soundness Analysis. Annex 2, Technical Analysis includes a synopsis of three studies of MSEs carried out by Coopers and Lybrand. Refer also to Annex 6, Proposed Research, Evaluation and Impact Studies and Human Resources Development for information on monitoring and special studies of target and non-target groups.

### (2) The MSE Beneficiaries

The major points relevant to the PSSP which emerged from the studies are summarized below.

- Commercial banks are much more likely to extend credit to enterprises of medium scale (100-500 employees, up to $5 million in annual sales) than to those of smaller scale (5-100 employees, up to $5 million in annual sales).

- The medium scale enterprises surveyed are mostly industries producing basic goods of primary necessity for local consumption and production: matches, bricks, paint, wood and metal products, soap, etc. All medium scale companies surveyed are located in Kinshasa.

- MSEs are currently experiencing an especially sharp decline in their access to foreign exchange through the banking system.

- Managers report that scarcity of foreign exchange has precipitated price rises (high cost of foreign exchange on the black market) and low plant utilization rates (scarcity of essential raw materials).

### (3) Ultimate Beneficiaries

Medium scale manufacturing represents a small percentage of total GDP, but these companies play an important role in the national economy. Most importantly, any program designed to expand the industrial sector, to encourage export industries or links to the agricultural sector, must build on the base of the industrial sector which already exists. The following sectors will be indirectly affected by the PSSP and these spread effects will be monitored. Refer to Annex 6, Proposed Research, Evaluations and Impact Studies.

1. Consumers: Access to foreign currency through the program will enable target MSEs to import essential raw materials and spare parts, thus lowering unit costs of production. This savings should be passed on to the

consumer because many companies compete with imports and also face declining purchasing power due to inflation.

2. Employees: Manufacturing companies provide a training ground for mechanics, engineers and office workers. This on-site training is of superior quality compared to other training resources in Kinshasa. MSEs are also a source of stable, long term employment in a rapidly expanding urban economy. Benefits for workers include dispensaries, medicines, payment of culturally important expenses such as funerals and marriages, retirement benefits, and access to food at below-market prices.

3. Subcontractors: Medium scale companies subcontract work to smaller enterprises such as printshops, wholesale food traders, laundry and transport services.

4. Marketing and Distribution Chain: Many companies have national distribution networks; some have branch factories in the interior. Most companies have recently cut back or eliminated distributor credit. Increased access to local currency enables companies to reestablish distributor credit, thus expanding their distribution networks.

5. Links to Agriculture and Rural Areas: Most companies in the medium size range either operate in Kinshasa or have their headquarters there. With increased access to credit, medium scale industries with branch factories and regional distribution will be able to expand their activities in the interior.

Some companies have direct links with agriculture or buy raw materials in rural areas, specifically those producing building materials and foodstuffs. One company provides credit to traders for agricultural buying campaigns. Special studies for the PSSP will show how to strengthen these supply links, especially working with USAID agricultural development projects. The local currency loan component will also provide credit for agricultural campaigns.

(4) Credit And Savings In The Informal Sector

Credit unions provide low-cost financial services to small enterprises and low-income individuals. However, they are able to extend very little credit in the current inflationary environment and are in need of a great deal of technical assistance to operate effectively. A USAID consultant study cautions against distributing foreign credit now through these institutions.

The cost of credit is high in the informal sector, and access is limited. Foreign exchange can be purchased in the parallel market at 25-30 percent above official prices. Suppliers' credit is available to preferred clients but this is drying up. Small companies' cash needs are also met by family or self-financing. For insurance and emergency funds, individuals rely on group savings mechanisms and rotating credit associations.

(5) Women's Role In The Private Sector

Women are underrepresented both as owners and employees in the MSEs surveyed for the Program. There was only one woman owner in the medium sized company survey and the average percentage of women employees was under 4 percent.

There are major barriers to women entering the formal private sector, especially industry:

- o A married woman must have her husband's permission to work or open a bank account.
- o Women are allowed four months maternity leave at 2/3 pay. With high birth rates and responsibilities for children, women are often absent from work.
- o Very few women enter technical institutions or receive technical training.
- o Unemployment rates are very high and priority for jobs goes to men in the household.

A few women are working in the MSEs, however, most as secretaries, but some on the shop floor. Some managers report that women are more productive than men. The social stigma attached to being a single working woman is gradually being relaxed, at least in the urban environment. In addition many men are beginning to appreciate a wife who works in the formal sector as she may be better educated and have access to a regular salary. Nevertheless, women's work and responsibilities are often issues of struggle in a household, especially where men do not feel secure about their own jobs and incomes. Thus, improvements in the overall economic climate will contribute to the security necessary to contemplate changes in gender roles. A special study conducted by a local women in development group will examine problems of and possibilities for women in the private sector. In addition, gender-disaggregated data will be collected at baseline and throughout the monitoring process of the MSEs. Refer to studies 1 and 8 in Annex 6, Proposed Research, Evaluations and Impact Studies.

Women's work in the informal sector - trading or providing services - avoids the visibility to taxation and licensing that registered companies and salaried work engenders. Women's contribution to the household through work in the informal sector has been shown to be substantial. A survey of informal savings and credit institutions will enable the Program to better understand the workings and needs of small enterprises, which sector accounts for the bulk of women-owned enterprises.

(6) Conclusions And Implications For Further Research

The direct beneficiaries of the PSSP are the MSEs, the commercial banks and the GOZ (see Part 2.4, Key Benefits, Annex 2, The Technical Analysis). Spread effects from the PSSP are suggested above. The depth and breadth of Program spread effects depend a great deal on developments in the wider economy, effective coordination with other projects within the Mission and with other donors. The Program seeks ways to help more directly smaller businesses, to link agriculture with industry, and to support women in the private sector. At this point, small companies, women traders, and rural based enterprises have little incentive or ability to enter the formal sector, but they can benefit through re-establishment of urban-rural linkages and increaseing demand by MSEs or by consumers for their products and services.

Similary, farmers can benefit through raw materials and food products.

Special studies suggested above, funded by the program may lead to interventions and policy changes directed toward aiding small-scaale and rural-based enterprises. The Program will also recruit women for special training in management and banking under USAID's AFGRAD and HRDA programs. The Small Project Support Project currently being designed will be able to reach these groups directly. For example, many credit unions are run by PVOs, and many PVOs have women's committees, sponsor income generating projects for women, and work with women's cooperatives and small businesses.

## 5.4 ADMINISTRATIVE ANALYSIS SUMMARY

This section examines the scope, adequacy and cost effectiveness of the overall management and administration of the PSSP.

The analyses of the PSSP work elements and the management implications of these elements are detailed in Annex 5, Administrative Analysis. The analytical approach used in establishing the PSSP's management and administrative structures started with an analysis of work elements and information flows required to launch and manage the program; then specified the types of institutional support required; and finally established the specifications for a detailed management information control and reporting system which would effectively link and permit coordination among the various participating organizations.

Fundamental to the design of the administrative structures proposed for the PSSP is the existence of an on-going and highly successful CIP program which has close working relationships with the national and international commercial trade banking system. This CIP unit will be incorporated directly into the proposed PSSP management and administrative system. For details on the functioning of the CIP, see Annex 7, Implementation Procedures for Private Sector Financing.

(1) Operational And Control Requirements

The PSSP has four major objectives which must be addressed in the design of the program's management and administrative systems.

- o Policy reforms and policy dialogue with the GOZ to restructure the financial sector and encourage commercial bank lending to small and medium sized private sector businesses.

- o Direct financial assistance to target private sector companies via private intermediary financial institutions in providing foreign exchange for essential imports and local currency loans for working capital.

- o Increased production and capacity utilization in MSEs, re-establishment of demand and supply linkages between urban and rural areas, and improved economic conditions for MSE employees, consumers, and smaller urban and rural producers.

- o Continuing and close cooperation with the IMF/World Bank and bilateral donor communities to ensure unity of purpose and approach in banking reform, improvements in the investment climate, and assistance to private sector development.

- o Continuing and close cooperation with the IMF/World Bank and bilateral donor communities to ensure unity of purpose and approach in financial sector reform, improvements in the investment climate, and assistance to private sector development.

These four major objectives impose a number of requirements which must

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be built in to the structure and systems of the PSSP.

- Active Involvement of USAID's Senior Management in continuing policy dialogue and consultation with the GOZ and the lending and donor community.

- A Strong Program Management Unit capable of supporting mission management in the policy dialogue process; managing, coordinating, and evaluating impact and the various participating organizations; and preparing periodic and special monitoring and evaluation reports with recommendations for future action.

- Participating Commercial Banks able to qualify importers, manage documentary credits, reimburse USAID with the local currency equivalents of foreign exchange payments made on behalf of importers, loans, collect and reimburse USAID local currency funds lent to private sector borrowers, and account for report on these transactions in a manner acceptable to USAID.

- A Fiduciary Bank to manage local currency fund disbursements and collections, prepare appropriate control reports, and carry out such other control responsibilities as may be assigned by USAID.

- A Consulting and Audit Firm qualified to carry out continuing private sector impact studies, evaluate participant performance under program criteria, and audit accuracy and timeliness of accounting and operating reports of participating commercial and fiduciary banks.

- Specialized Short Term Consultants to conduct analyses and surveys of the socio-cultural environment, women in development, micro sector lending opportunities, informal lending sector, group approaches to small business and micro lending, impacts of project activities and related subjects.

The structuring and management information systems required for the orderly planning, implementation, operations and control reporting of these multiple requirements and participating organizations are summarized below.

(2) Administrative Structure And Responsibilities Of Participants

Several guiding principles were established in designing the administrative structure and systems for the PSSP.

- Delegate to the maximum extent possible the day-to-day operational requirements to outside private sector participating organizations.

- Establish criteria and reporting requirements for participating bank lenders and private sector company borrowers in the use of foreign exchange and local currency, but play no role in the credit, lending and collection process as it involves the lending bank and the borrower.

- Concentrate the attention of senior USAID management on macroeconomic and banking system reforms, continuing policy dialogue, and donor coordination.

- o Establish a strong and highly qualified Program Management Unit capable of supporting USAID management, providing guidance and direction to outside research and audit organizations, fiduciaries and consultants, and monitoring and evaluating progress against program plans and schedules.

- o Integrate into the PSSP to the maximum extent possible the mission's fully functioning CIP management unit.

Exhibit 5.1, Structure And Relationships, which follows this page, illustrates the basic structure and relationships of the participating organizations.

(3) The PSSP Program Management Unit

The Program Management Unit (PMU) which reports directly to the PDO Division Chief has been structured and staffed to carry out a full range of planning, research, program management, coordination and control, and monitoring-evaluation-audit functions. It supports senior mission management in on-going macroeconomic analyses, policy dialogue with the GOZ, and policy and program coordination with the donor community.

The PMU will also function as a private sector strategy development unit since the PSSP represents the mission's major private sector initiative from which other projects and programs will be generated. The Program Manager of the PMU will, as a result, also serve as the mission's Private Enterprise Advisor.

The Program Manager will directly supervise the work of three positions:

- o Financial Sector Economist who will coordinate with the Bank of Zaire on banking reforms.

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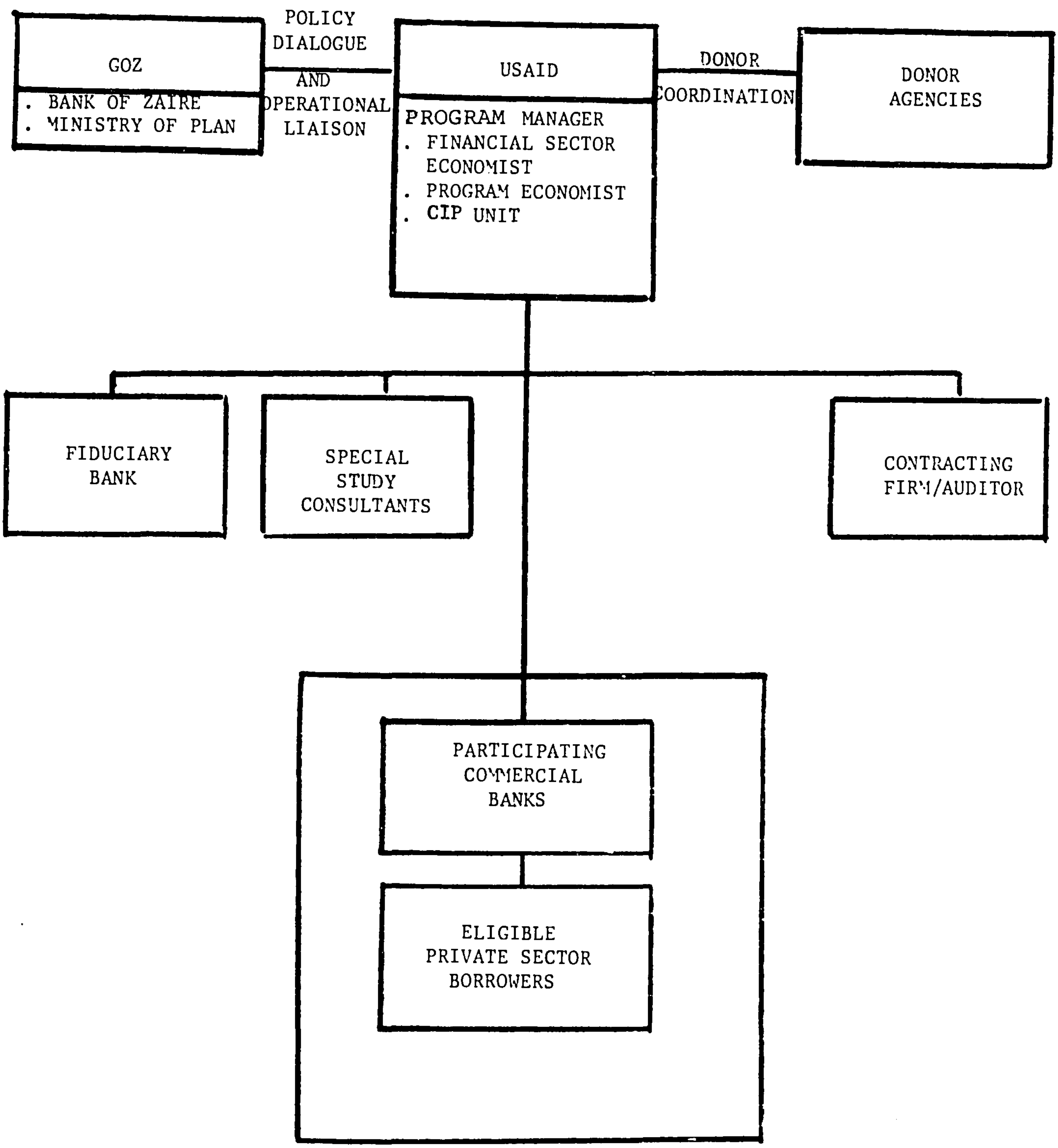
EXHIBIT 5.1

STRUCTURE AND RELATIONSHIPS

PRIVATE SECTOR SUPPORT PROGRAM



- Program Economist who will be responsible for on-going reviews and studies of the macroeconomic environment, the investment climate, policy reform and conditionality issues. The program economist will also work closely with outside consultants retained for PSSP and private sector studies.

- CIP Unit Manager who will continue to carry out AEPRP CIP responsibilities, but will assume the same role for the PSSP. The current CIP unit with its policy and procedure framework and close connections with the banking sector can assume the PSSP functions with few changes in its methods of operation and at little additional cost.

Consult Annex 5, Administrative Analysis, for further discussion of the PMU and more detailed descriptions of the key positions.

(4) Importance Of The Currently Installed And Operating CIP Program

The mission's current and highly successful CIP program will be integrated into the PSSP from both an organizational and systems point of view. The existence of this unit will greatly simplify program start up and guarantee effective relationships with all participating banks with whom the unit has day-to-day working contacts on all phases of commodity import, letters of credit, fiduciary bank relationships, counterpart fund management, and monitoring, evaluation and control reporting. Annex 7, Implementation Procedures for Private Sector Financing, details the CIP procedures and mechanisms.

(5) Cost Effectiveness

The organization and administration systems of the PSSP have been designed to delegate maximum operating responsibilities to participating banks in a manner consistent with their normal customer and lender relationships in Zaire, and their existing correspondent banking relationships abroad. The participating banks will be directly responsible for the recovery and repayment to USAID counterpart funds of the local currency equivalent of the foreign exchange employed regardless of the repayment status of the borrower. These banks will charge the private sector borrower their normal service fees and bear all lender/borrower risks. No further USAID funds will be paid to these banks for their services.

The administrative system proposed in the PSSP fully utilizes the mission's current in-place CIP capability. No new structure nor major changes in systems are anticipated.

All consulting, advisory and audit work undertaken by the PSSP will be competitively awarded on the basis of detailed scopes of work against detailed cost estimates.

The major operating costs of the PSSP are in the Program Management Unit. The design of the unit will permit not only supervision of the PSSP, but make major contributions to mission macroeconomic analyses, continuing policy dialogue, private sector strategy development, and donor coordination.

(6) Management Information and Control System

Detailed analysis of dollar and zaire disbursements, document flows, approvals, and monitoring and control procedures for the CIP and local currency loan program are described in their actual sequence in Annex 7, Implementation Procedures for Private Sector Financing. In addition, major monitoring and reporting activities for the CIP and LCLP by each participating organization are summarized in Annex 5, Administrative Analysis.

## 6. CONDITIONS AND COVENANTS

The establishment of appropriate conditions and covenants for the PSSP must be directly linked to the program purpose and goal.

- The purpose of the PSSP is to restructure the Zairian financial and especially commercial banking sector to enable it to support productive investment by medium and smaller-scale enterprises (MSES)

- The longer term goal is the establishment of a free and efficient financial sector supporting development of the private sector, in particular lending to medium and smaller scale enterprises.

### 6.1 Program Monitoring - Benchmarks

A number of guidelines were established to assist in the development of "benchmarks" for monitoring progress in reaching the program's goal and purpose. These benchmarks, negotiated and agreed upon between USAID and the GOZ, will serve as the basis for the bi-annual program review with the GOZ. They will also serve as guidelines to the Mission in determining whether compliance, in spirit, with the covenants and "CP's" has been achieved. Guidelines used in developing program benchmarks are to:

- Have relevance and contribute to specific PSSP goals and objectives.

- Facilitate the successful operation and management of the program.

- Be focused and specific enough to be defined, programmed, scheduled and installed - and provide some form of objective task and time benchmarks for measuring GOZ performance.

- Have a reasonable chance of being installed and operative over the LOP.

- Contribute in a coordinated and visible manner to agreed GOZ and donor policy reforms agendas and timetables.

- Not place onerous burdens on a government with limited capabilities, already attempting to handle a large and diversified menu of policy reforms.

- Be designed to provide some flexibility and a "rolling" assessment of progress towards benchmarks rather than the fixing of over-rigid targets and deadlines.

The conditions, covenants, benchmarks, and policy dialogue mechanisms established for the PSSP are described below.

### 6.2 Program Links To World Bank Financial Sector Adjustment Credit (FSAC)

At the request of the GOZ there have been intensive consultations with the World Bank in order to coordinate the programs and conditionalities of the Financial Sector Adjustment Credit (FSAC) with the PSSP. It is likely that agreement on the FSAC will be reached before the end of 1988. Certain reform measures proposed by the FSAC have, in fact, already been taken:

a 10 percent increase in Bank of Zaire interest rates and a decision to strengthen the National Institute of Social Security. Other reform measures will follow when the FSAC is in place. Over the long term, the FSAC seeks other reforms which parallel or are in close harmony with reforms sought by the PSSP.

- Further adjustments in money market interest rates.
- Reductions in BDZ loans in the money markets.
- Expanded institutional participation in the money market.
- Reform in interest rates on treasury bonds.
- Reform in calculation of bank reserve requirements.
- Strengthening of BDZ supervision of commercial banks.
- Restructuring of public sector financial institutions.

### 6.3 Covenants

#### (1) Macroeconomic Covenants

The PSSP is predicated on the continuation of liberalization, stabilization and structural adjustment programs which the GOZ has been following in recent years. The following macroeconomic covenants will be included in the grant agreement:

- Limitations on the GOZ budgetary deficit.
- Maintenance of free interest rates.
- Maintenance of floating exchange rates.
- Maintenance of full cost fuel pricing.
- Maintenance of liberalized pricing policy for agricultural and industrial products.
- Continuation of tariff reform.

#### (2) AID/GOZ Consultative Process

In addition, a covenant will be included under which the GOZ agrees to meet with AID bi-annually, to monitor compliance with the various conditions and covenants of the Program Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the program, review the results of program activities and establish conditions precedent which shall apply to subsequent disbursement under the program. In addition, not less than six months after the signing of the Program Agreement, the GOZ will agree with AID on a list of criteria with which to monitor the progress of financial reform toward the objectives outlined in the Financial Sector Development Policy Statement or as undertaken as reform measures. These criteria may include but need not be limited to the following:

(a) the real growth of domestic financial resources and private savings held by the banking system;

(b) the reduction in the gap between the Bank of Zaire's lending rates of interest and the inflation rate;

(c) the increase in the real value of credit extended by the banking sector to the private sector; and

(d) a shift from direct to indirect methods of controlling the money supply following successful and sustained macroeconomic stabilization.

(e) the degree to which commercial banks are financing a wider range of enterprises than before in terms of size, sector of activity, and geographic area.

## 6.4 Programmatic Conditions Precedent To The First Release

The GOZ will confirm its commitments to continuing financial sector reform and development, and agree to work with USAID and other donors in defining, pursuing and evaluating program performance. These requirements will be formalized as conditions precedent to the release of the first tranche of dollar import funding.

- The GOZ will issue a Financial Sector Development Policy Statement embodying a liberal, private sector oriented approach consistent with the structural adjustment program.

The statement will include specifically the following objectives for the financial sector under this program:

(1) By the end of the program, real financial resources mobilized by private commercial banks should be growing by at least 4 percent per year.

(2) Interest rates should be positive relative to inflation.

(3) Commercial banks should be financing a wider range of enterprises than before the program in terms of size, sector of activity, and geographic area.

(4) The GOZ budget deficit should be financed from the market at market rates of interest, rather than monetarily at near zero interest as at present.

(5) No GOZ constraints should remain on bank interest rates or fee structures.

(6) Required reserves should be set at minimum levels necessary for stability of the banking system.

(7) Required reserve deposits should be remunerated at market price.

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(8) The Central Bank should be acting only as lender of last resort and should change market-based interest rates.

(9) The GOZ should be moving to replace administrative credit ceilings (direct controls) with indirect controls on credit that are automatically linked to mobilization of resources by the banking system.

- The GOZ will name the representatives to regular bi-annual consultations with USAID in the context of the PSSP on the content and implementation of the Financial Sector Program.

### 6.5 Conditions Precedent to Release of the Second Tranche

Prior to the second disbursement under the Program Agreement, the GOZ will be expected to make substantial progress in reaching its financial sector reform objectives by:

(1) reducing commercial bank reserve requirements to minimum levels necessary for stability of the banking system;

(2) removing remaining constraints on bank interest rates or fee structures

(3) reducing the gap between the rate of inflation and the Bank of Zaire money markekt rate;

(4) reducing total commercial bank obligations to the Bank of Zaire as a proportion of required reserves relative to the level of December 31, 1987.

The first Program Implementation Letter (PIL) will describe the specific degree of progress expected, given economic conditions at the signing of the Program Grant Agreement.

AID will obligate funds to the program annually. Decisions on subsequent releases of dollar import funding will be made twice annually in the context of GOZ-AID bi-annual consultations on the progress in the financial sector reform program. These consultations would occur following IMF and World Bank supervisory missions on the structural adjustment program.

In these consultations, the GOZ and AID would review performance in fulfilling conditions precedent, consider overall progress in financial sector development, and establish expected performance for the next period.

Given the current state of development of the financial sector reform program and plans for reform measures by the GOZ, AID would expect the following conditions to have been achieved by time of the first six-month consultative meeting:

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--- Gap between BDZ exchange rate and uncontrolled market rates of no more than 20 percent.

--- Inflation rate no more than 75 percent.

--- Gap between inflation and BDZ's lending interest rate in the money market reduced to no more than 35 percentage points. For example, if inflation rate does not fall below 75 percent by the end of 1988, BDZ's nominal lending rate in the money market must increase above the April, 1988 rate of 35 percent. Interest rates on BDZ rediscounts and advances to commercial banks must equal or exceed the money market interest rate.

--- Reserve requirement of 10 percent or less on deposits of more than 3 and less than 6 months. Reserve requirement of 5 percent or less on deposits of 6 months or more.

--- Reduction of total commercial bank obligations to the BDZ as a proportion of required reserves by at least 5 percentage points relative to the level of December 31, 1987.

USAID does not wish to establish rigid and exact quantitative measures as conditions precedent to the second release because meeting these specific targets requires changes in a number of exogenous factors. Some of these exogenous factors may be outside the control of the GOZ. If the GOZ was unable to meet one or two of these specific targets but was still judged to be making sufficient progress toward the major financial sector objectives, AID would wish to have the flexibility to approve a release. Applying these targets as rigid conditions would remove this flexibility.

### 6.6 Conditions Precedent To Subsequent Releases

Subsequent releases of dollar import funds would be based on the GOZ's meeting satisfactorily two conditions:

(1) The GOZ will undertake those measures agreed upon with AID during the bi-annual GOZ/AID program consultations to execute financial sector reforms, including measures at attaining the specific objectives identified in the Financial Sector Development Policy Statement for the purpose of:

(a) promoting the mobilization by commercial banks of domestic financial resources and private savings;

(b) fostering a more active money market and interest rates more representative of the real economic cost of funds; and

(c) increasing the amount of credit in real terms available to the private sector.

(2) The GOZ will demonstrate during the regular GOZ/AID program consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the program.

## 6.7 Establishment And Interpretation of Benchmarks

Benchmarks will be established to assess progress towards major objectives for the financial sector. While the fundamental objective of the PSSP will remain private sector growth, two specific underlying problems have been identified for which solutions can be found and progress towards objectives measured. These are mobilization of resources by the financial sector, and efficient allocation of these resources to the private sector.

- Increased Mobilization Of Private Domestic Resources By The Financial Sector

The PSSP will monitor the change in real value of private deposits in the commercial banks. The exact nature of the deposits to be calculated and a method for deflating current values to calculate real growth will be determined and agreed upon in the GOZ/AID consultative meetings and through PSSP-funded studies, if necessary.

- Efficiency In Allocation Of Domestic Financial Resources To The Private Sector

The PSSP will monitor the real cost of funds to the banking sector, in particular the rate of interest in the money market relative to the rate of inflation. The proposed benchmarks for progress in the reduction of the gap between inflation and the money market would be set at the bi-annual GOZ/A.I.D. consultations and would be based on likely and possible progress during the next period. The objective would be the return to positive interest rates relative to inflation as soon as is feasible. These benchmarks would not be proposed as conditions precedent to fund disbursement. They are meant to serve as quantitative indicators of whether overall economic environment and development measures are achieving results. The GOZ would, however, be asked to commit itself to seek measures to improve the structure and incentives in the financial sector to help achieve PSSP objectives. USAID would agree to commit additional funds to the program after each six-month review, provided the GOZ continued to make good-faith efforts to devise and install measures needed to improve performance of the financial sector relative to the benchmarks.

## 6.8 Further Financial Sector Studies And Reform Measures

The PSSP will provide for a number of financial sector studies which will be undertaken during the course of the program under consultation with the GOZ. The results of these studies will be used to establish additional and improved benchmark monitoring measures and to suggest additional performance conditions where required. Studies will include some of the following topics:

- Methods for measurement of real interest rates (RIR) and growth in real bank deposits.

- Offsetting reduced BDZ lending to banks with reduced reserve requirements: cost and benefits.

- Exclusion of agricultural campaign credit from credit ceilings: cost and benefits.

- o Direct BDZ financing of the budget deficit: cost and benefits.

- o Pre-conditions required for replacement of administrative credit ceilings by indirect controls.

Bi-annual program reviews with the GOZ will be used to determine the actual studies undertaken and to develop additional reform measures as the program unfolds.

### 6.9 GOZ-USAID Coordination Of The PSSP

Since the PSSP is to be implemented over a five-year period, a formal mechanism will be established to ensure coordination of the government's medium term financial sector development programs - FSAC and SAL II - with the PSSP. The program agreement will provide for twice-yearly GOZ-USAID meetings to include the Bank of Zaire. These meetings would review and consider the following:

- o The performance of the financial sector relative to agreed benchmarks.

- o The reasons for satisfactory or unsatisfactory performance relative to these benchmarks: to include contribution of policy measures and the impact of exogenous events.

- o Implementation status of previously adopted measures.

- o Disbursements and recoveries of PSSP private sector loans.

- o Impact of PSSP financing on both the financial sector and private enterprises.

- o Status of policy studies or program interventions.

- o Additional measures required for the success of the program.

Meetings would normally be scheduled after GOZ- World Bank/IMF meetings on policy-based lending programs in order to utilize macroeconomic and financial information normally prepared in advance of such meetings.

### 6.10 Long-Term Objectives For The Financial Sector Policy Environment

Studies and monitoring of the progress of both the lending and policy elements of the PSSP will be necessary to identify and negotiate further measures in the context of the ongoing Structural Adjustment Program. USAID's long-term vision of the policy environment governing bank credit and mobilization of resources would be characterized by:

--- Control of aggregate liquidity through indirect means (control over the monetary base) rather than through

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- o Direct BDZ financing of the budget deficit: cost and benefits.

- o Pre-conditions required for replacement of administrative credit ceilings by indirect controls.

Bi-annual program reviews with the GOZ will be used to determine the actual studies undertaken and to develop additional reform measures as the program unfolds.

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- o The performance of the financial sector relative to agreed benchmarks.

- o The reasons for satisfactory or unsatisfactory performance relative to these benchmarks: to include contribution of policy measures and the impact of exogenous events.

- o Implementation status of previously adopted measures.

- o Disbursements and recoveries of PSSP private sector loans.

- o Impact of PSSP financing on both the financial sector and private enterprises.

- o Status of policy studies or program interventions.

- o Additional measures required for the success of the program.

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## 6.10 Long-Term Objectives For The Financial Sector Policy Environment

Studies and monitoring of the progress of both the lending and policy elements of the PSSP will be necessary to identify and negotiate further measures in the context of the ongoing Structural Adjustment Program. USAID's long-term vision of the policy environment governing bank credit and mobilization of resources would be characterized by:

--- Control of aggregate liquidity through indirect means (control over the monetary base) rather than through direct administrative credit controls.

--- Financing of the Treasury's needs primarily through borrowing from the public (including financial institutions) at market interest

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rates, rather than from the central bank.

--- An independent central bank monetary policy centering on stability in nominal aggregate demand.

--- Minimal prudent required reserves in interest-bearing form, along with prudent supervisory controls of the banking system's capitalization and risk exposure.

--- Absence of administrative controls on interest rates, credit allocations, exchange rates, or banking fees and commissions.

88x

## 7. EVALUATION

The quick disbursement objectives established for each tranche of the PSSP foreign exchange grant require that participating intermediary financial institutions obligate and disburse dollars on behalf of qualified private sector businesses as quickly as possible. While success in attaining the longer term objectives and in assessing impact of the PSSP can only be measured over years, the short term objective of increasing access of qualified private sector MSE importers and borrowers can and will be monitored and evaluated literally on a month-to-month basis.

The nature of the PSSP, therefore, requires very careful coordination of the planning of the approach to and systems for both the monitoring and evaluation of the program. In this regard, refer to Section 4, Monitoring Plan, Annex 1, Logframe Matrix, and Annex 5, Administrative Analysis.

### 7.1 An Overview Of The PSSP Monitoring And Evaluation System.

The PSSP directly involves four major public and private sector entities or beneficiaries all of whom will receive "input" benefits and are expected to achieve "output" results.

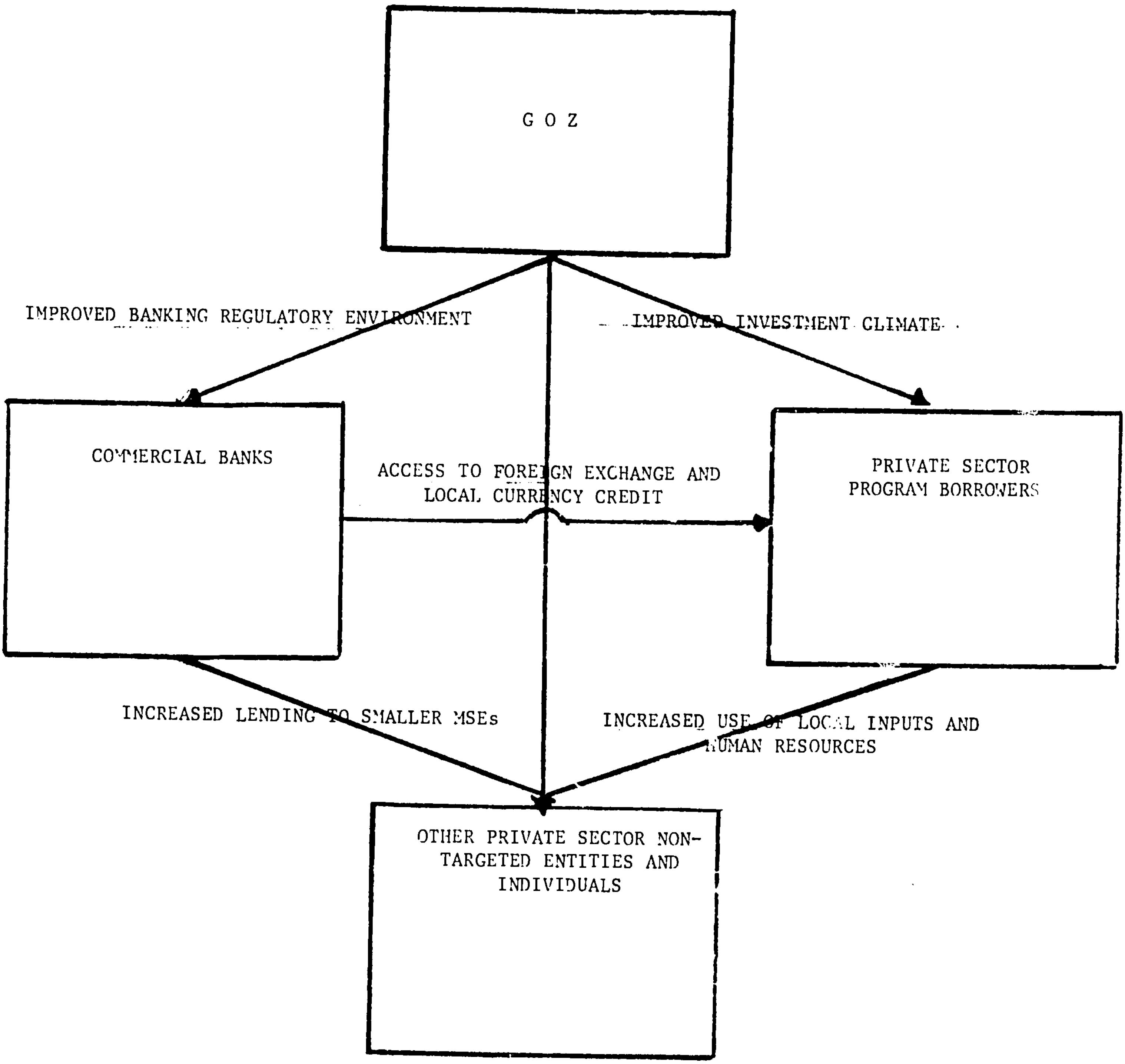
- The Government of Zaire which receives a dollar grant in exchange for policy reforms.
- The Participating Commercial Banks which obtain access to additional foreign exchange and local currency on behalf of their private sector customers and benefit from profitable fees obtained for letter of credit and exchange transactions, and from incremental interest income from term lending. In return, the banks undertake to increase term lending to private sector borrowers.
- Targeted Private Sector Companies which receive foreign exchange and local currency term credit for essential imports, working capital and local purchases for increasing production and expanding their enterprises.
- Non-Targeted Private Sector Entities and Individuals which benefit from an improved investment and banking climate and access to credit, and contribute to achievement of a higher level of productive private sector economic activity. This included MSE employees, consumers, and smaller urban and rural producers.

The performance of all these participant beneficiaries must be taken into account in the design of the monitoring and evaluation system if attainment of PSSP objectives is to be measured. Exhibit 7.1, Relationships Among PSSP Program/Beneficiaries, which follows this page, illustrates the linkages among the major beneficiaries.

The approach used in designing the monitoring and evaluation system started with a definition of the current situation, looked ahead to end-of-program goals and objectives, and then determined the intervening needs for monitoring, evaluating, and assessing on a short and long term basis program performance against targets.

EXHIBIT 7.1

RELATIONSHIPS AMONG PSSP PROGRAM/BENEFICIARIES



o The Current Situation

Baseline data was collected on the current status, activities and performance of all particpants. This baseline data included GOZ reports, IMF/World Bank statistics and economic summary reports, banking sector and individual bank operating and financial statements and analytical reports, and comprehensive consulting surveys commissioned by USAID on the private sector, the banking system, socio-economic environment, and the overall investment climate.

o End Of Program Goals And Objectives

PSSP goals and objectives were established for each of the participating beneficiaries and specific quantitative and qualitative measures established for measuring progress towards objectives as measured from the baseline data.

o The Monitoring, Evaluation And Assessment System

The PSSP design attempts to coordinate in a meaningful way the monitoring, impact and special studies and evaluation programs to satisfy operational, short and medium term and end-of-program assessments of performance and goal-objective attainment. Refer to Exhibit 7.2, Monitoring and Evaluation Overview, which follows this page, for a graphic portrayal of the monitoring and evaluation plan.

## 7.2 The Measurement Of Program Performance.

Program "evaluation" will be an on-going task of the Program Management Unit supported by outside consultants and auditors. Formal "Evaluations" will be scheduled at 18 months, 3 years, and EOP intervals. Formal evaluations will utilize essentially the same measurement criteria, the baseline data sources, program performance information and the methodology employed by the PMU in its on-going monitoring activities.

The monitoring and evaluation plan takes each one of the target beneficiaries - GOZ, Commercial Banks, Targeted Private Sector MSE borrowers, and Non Targeted Private Sector Entities and Individuals, - and analyzes these key evaluation elements: program "input" to the beneficiary, expected "output" from the beneficiary, and qualitative and quantitative measurements of outputs against plan. Exhibit 7.3, Major Elements For Monitoring and Evaluation, which follows this page examines each of these elements and provides the basis for the PSSP's monitoring and evaluation system.

Monitoring and evaluation of conditionalities and performance benchmarks are also built into the PSSP. Refer to Section 6, Conditions And Covenants, for a discussion of proposed targets and measures for assuring performance against these conditions and benchmarks.

EXHIBIT 7.2

MONITORING AND EVALUATION OVERVIEW

- PRIVATE SECTOR SUPPORT PROGRAM -

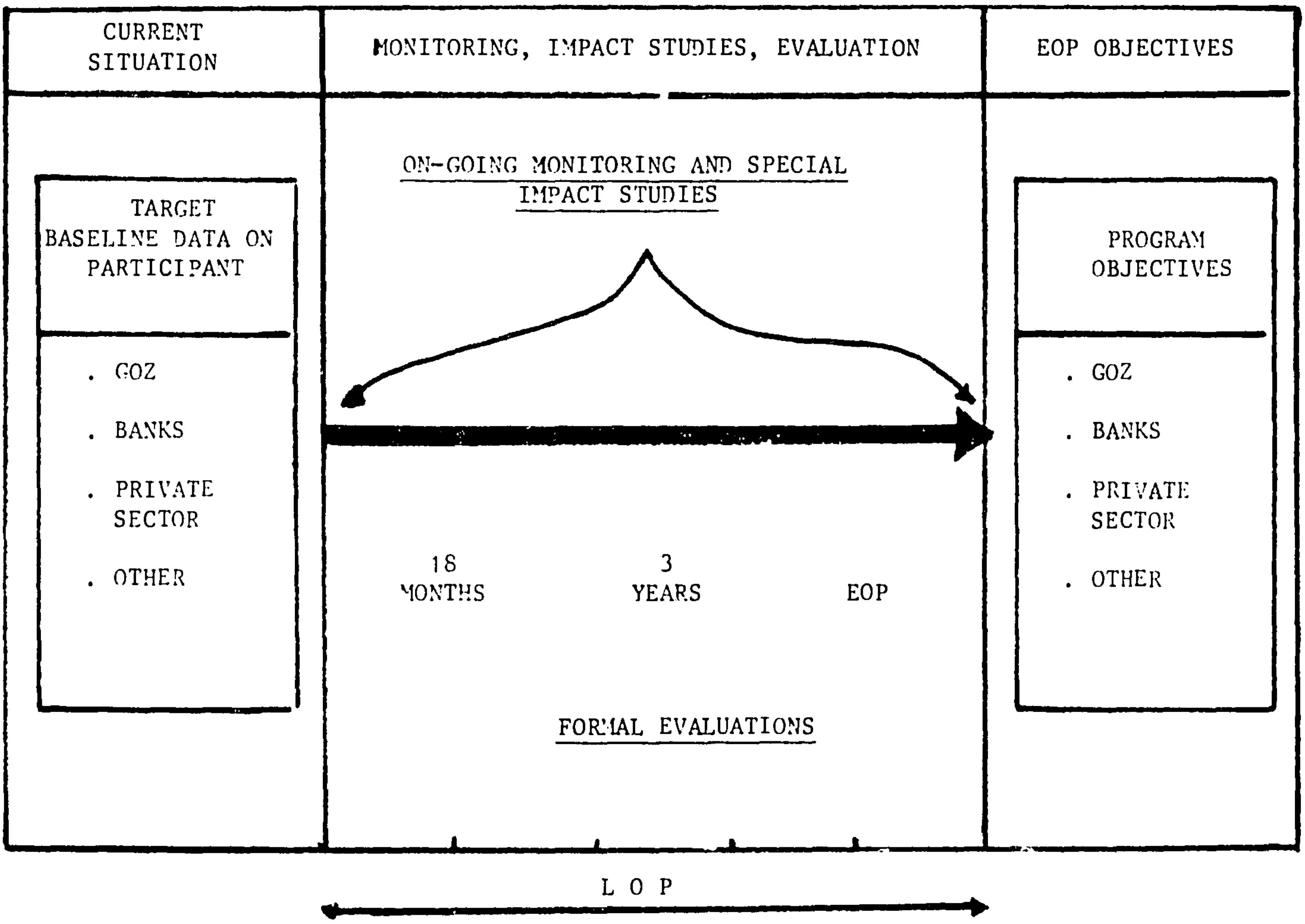



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EXHIBIT 7.3

## MAJOR ELEMENTS FOR MONITORING AND EVALUATION

PRIVATE SECTOR SUPPORT PROGRAM

| TARGET BENEFICIARY | PSSP INPUT TO BENEFICIARY | PSSP EXPECTED OUTPUT FROM BENEFICIARY | PROGRESS MEASUREMENTS |
|---|---|---|---|
| GOVERNMENT OF ZAIRE | 1. $35 MILLION QUICK DISBURSING GRANT FOR RESTRUCTURING COMMERCIAL BANKING SECTOR | 1. POLICY AND REGULATORY REFORMS | |
| | | 1.1 Publish Financial Development Policy Statement | 1.1 Publication of statement |
| | | 1.2 Maintain liberalization policies re exchange rates, deficits, free interest rates, price liberalization tariffs, and balance of payments. | 1.2 Declining interest rates, positive real interest rates, reduced deficits price reforms and improvements in balance of payments. |
| | | 1.3 Take appropriate and timely actions to meet PSSP conditionality benchmarks: incent banking system to profitably mobilize national liquidity and increase term lending to private sector MSE segment; promote active banking money market; liberalize bank reserve requirements and credit ceilings. | 1.3 Increase in real deposits in banking system and depositor base; increase in bank term lending to private sector MSEs; active bank money market; liberalized bank reserve requirements; and more rational determination of bank credit ceilings. |
| | | | 1.4 Sources: GOZ, IMF, World Bank reports; PSSP monitoring reports; participating and fiduciary bank reports; special consulting and audit reports; evaluations. |

| | | | |
|---|---|---|---|
| Exhibit 7.3 Cont'd. | 2. <u>TECHNICAL ASSISTANCE TO GOZ FOR FINANCIAL SECTOR REFORM PROGRAM</u> | 2.1 GOZ/USAID Consultations on financial sector reform recommendations.<br><br>2.2 Action plans and timetables prepared for agreed reforms.<br><br>2.3 Agreed reforms enacted. | 2. IMF and World Bank dialogue, monitoring reports, special studies and evaluations. |
| <u>COMMERCIAL BANKS</u> | 1. <u>ACCESS TO $35 MILLION TO MEET CUSTOMER DEMAND FOR FOREIGN EXCHANGE WITH NO FX RISK AND PROFITABLE TRANSACTION FEE STRUCTURE</u> | 1.1 Participating banks draw down FX fund for qualified private sector customers on a quick-commitment quick-disbursment basis.<br><br>1.2 Participating banks review and qualify borrowers and imports against USAID-specified borrower targets, commodity specifications and sourcing requirements. | 1. Foreign exchange drawdowns meet USAID-determined disbursement targets. Participating and fiduciary bank reports, monitoring reports, special consulting surveys, and evaluations. |
| | 2. <u>DELAYED TERM REPAYMENT TO USAID OF LOCAL CURRENCY EQUIVALENT OF FX DRAWDOWNS.</u> | 2.1 Banks pass on USAID local currency term payment conditions to private sector borrowers.<br>2.2 Banks repay local currency<br>2.2 Banks repay local currency equivalent of fx to counterpart fund on agreed terms and schedules. | 2. Borrowers receive preferential local currency short term payment conditions. Local currency repayments made on schedule. Participating and fiduciary bank reports, monitoring reports, special studies and audits, and evaluations. |



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Exhibit 7.3 Continued

| | | | |
|---|---|---|---|
| | 3. IMPROVED BANKING ENVIRONMENT RESULTING FROM GOZ POLICY AND REGULATORY CHANGES (See 1 above) | 3.1 Banks expand their local currency deposit and depositor base in real terms.<br><br>3.2 Banks make longer term loans to smaller private sector borrowers.<br><br>3.3 Banks realize greater share of the national money supply.<br><br>3.4 Bank lending portfolios to SME borrowers are profitable. | 3. Trends in mobilization of money supply and loans to SME borrowers increasing in real terms. Central bank, commercial and fiduciary bank reports, IMF/World Bank reports and statistics, program monitoring and evaluation reports, and special consulting surveys. |
| | 4. ACCESS TO LOCAL CURRENCY FROM USAID COUNTERPART FUND FOR ON-LENDING TO PRIVATE SECTOR MSEs | 4. Participating banks increase volume in real terms of term lending to target private sector SMEs. | 4. Central bank, participating and fiduciary banks, and program monitoring reports. Special impact and research surveys and evaluations. |
| TARGETED PRIVATE SECTOR SME BORROWERS | 1. ACCESS TO FOREIGN EXCHANGE FOR ESSENTIAL COMMODITY IMPORTS ON FAVORABLE REPAYMENT TERMS AND NO FOREIGN EXCHANGE RISK | 1.1 Targeted private sector MSEs have access to FX for critical imports.<br><br>1.2 Critical imports result in increased production and plant utilization levels, higher productivity, enhanced capital utilization, investments in expansion or new business ventures, increased use of local production inputs and human resources | 1.1 Participating and fiduciary bank reports, monitoring and evaluation reports, and special studies and audits.<br><br>1.2 Special surveys by outside consultants, and evaluation reports to measure change. |
| | 2. ACCESS TO LOCAL CURRENCY TERM LOANS | 2. Availability of local currency for working capital and local currency investments result in expanded business activities. See 1.2 above. | 2. See 1.1 and 1.2 above. |

| | | | |
|---|---|---|---|
| NON TARGETED PRIVATE SECTOR ENTITIES AND INDIVIDUALS | 1. INCREASING ACCESS TO LOCAL CURRENCY CREDIT OVER LOP | 1.1 Increasing short and medium term local currency lending as investment climate and banking regulatory environment improves.<br><br>1.2 Increased employment opportunities from business expansion of both targeted and non targeted business expansion.<br><br>1.3 Increased demand for locally produced inputs. | 1. Participating banks non-traditional private sector term lending portfolios increase in real terms. Participating and fiduciary bank reports, monitoring and evaluation. Measurement of 1.2, 1.3 and 1.4 by special consulting surveys. |

Exhibit 7.3 Continued

| | | | |
|---|---|---|---|
| <u>PRIVATE SECTOR - GENERAL</u> | 1. <u>IMPROVED BANKING AND INVESTMENT CLIMATE</u> | 1.1 Growing confidence in the investment climate and banking system encourages risk taking, new investments and expansion of private sector activities.<br><br>1.2 Increased utilization of installed plant capacity results in increases in employment opportunities and higher levels of local inputs.<br><br>1.3 Banks increasingly expand term lending to private sector MSEs and entrepreneurs. | 1. General improvement in business climate and economic indicators. Private sector investment increasing. Plant utilization and new business start ups. Banks increasingly involved as local currency term lending intermediaries based on major local currency deposit bases. GOZ, central bank, IMF/World Bank, participating and fiduciary bank reports, monitoring and evaluation reports, and special consulting surveys. |

ANNEX 1

LOGFRAME MATRIX

- PRIVATE SECTOR SUPPORT PROGRAM -

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ANNEX I

## LOGICAL FRAMEWORK

PRIVATE SECTOR SUPPORT PROGRAM

| NARRATIVE SUMMARY | OBJECTIVELY VERIFIABLE INDICATORS | MEANS OF VERIFICATION | IMPORTANT ASSUMPTIONS |
|---|---|---|---|
| Program Goal: The broader objective to which this Program contributes: | Measures of Goal Achievement: | | Concerning long term value of program/project: |
| Establish a free and efficient financial sector which will support development of Zaire's private sector, especially lending to medium and smaller scale enterprises. | 1. Commercial bank local currency deposits expanding.<br>2. Commercial banks making longer term loans to smaller private sector borrowers.<br>3. Regional bank branches expand lending capacity and loan portfolios.<br>4. Higher proportion of money supply found in formal financial institutions (50% today).<br>5. Term lending becomes a more important and profitable part of the financial services offered by commercial banks. | 1. Central Bank reports, IMF and World Bank reports.<br>2. Commercial bank annual reports.<br>3. Program monitoring reports and evaluations.<br>.Commercial bank loan portfolios.<br>.Private sector loans made under PSSP.<br>4. Program impact studies. | 1. Zaire's economic recovery indicators are positive and World Bank/IMF will continue to offer support.<br>2. GDP grows modestly.<br>3. The rate of inflation will be held constant or reduced, thus making it possible to set interest rates in real terms.<br>4. Official and parallel exchange rates remain in a band range of 20%.<br>5. No major negative economic or political upheavals. |

Page 2 Logical Framework

| NARRATIVE SUMMARY | OBJECTIVELY VERIFIABLE INDICATORS | MEANS OF VERIFICATION | IMPORTANT ASSUMPTIONS |
|---|---|---|---|
| Program Purpose: | EOPs: | | Purpose to Goal: |
| To restructure the Zairian commercial banking sector to support productive investment by medium and smaller scale enterprises. (MSES) | 1. Financial sector reforms begin to establish an improved incentive framework that will encourage increases in real value of resources mobilized and credits allocated by commerical banks to the private sector.<br>2. Structural or institutional constraints to financing private enterprise are identified which may be reduced or removed by this or future projects.<br>3. MSE employees, consumers, and smaller urban and rural producers benefit, respectively from increased employment, greater supplies of basic consumer goods, and improved urban markets for agricultural and other products. | 1. Commercial and fiduciary bank reporting<br>2. Monitoring reports and evaluations.<br>3. Separate studies carried out by consultants and contractors including annual impact surveys. | 1. GOZ/IMF agree to policy changes which make it feasible to mobilize domestic savings and profitable to make short<br>2. Stabilization and structural adjustment measures control money supply and inflation appropriatly.<br>3. Private sector confidence in the financial sector increases.<br>4. IBRD Structural Adjustment Loan and other similar funding buttress these reforms and continue over LOP.<br>5. IBRD and USAID projects complement each other. |



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Page 3 Logical Framework

| NARRATIVE SUMMARY | OBJECTIVELY VERIFIABLE INDICATORS | MEANS OF VERIFICATION | IMPORTANT ASSUMPTIONS |
|---|---|---|---|
| **Outputs** | | | |
| 1. Policy and regulatory reform conditions identified, developed and enacted. | 1.1 Consultations held, studies carried out, recommendations developed.<br>1.2 Action plan and timetable developed actions taken and conditions met. | 1. Monitoring reports and evaluations and separate studies by consultants.<br>2. PIRs<br>3. Fiduciary bank reports and audit reports of commercial bank lending. | 1. C.P.s to initial and subsequent disbursements met.<br>2. IMF and IBRD reforms consistent with program.<br>3. Private sector willing and able to change investments strategies.<br>4. Private sector and the public regain confidence in banking sector.<br>5. Markets for MSE products will develope of expand.<br>6. There are suficient viable MSEs to whom banks are willing to lend. |
| 2. Commercial banks increase lending to private enterprises, especially medium-scale and smaller enterprises (MSEs). | 2.1 S-T and M-T loans to MSEs increase to both traditional and non-traditional MSE borrowers.<br>2.2 MSEs meeting repayment repayment schedule.<br>2.3 MSE loans are distributed over wider range of size of enterprises, geographic locations, and sectors.<br>2.4 Increase in numbers of MSEs serve by each participating bank. | | |
| 3. MSEs and smaller enterprises benefit from lending and access to broader range financial services from commercial banks. | 3.1 Higher number of MSEs enjoy permanent credit relationships with banks.<br>3.2 Increase in MSE capacity utilization, production and profitability. | | |

Page 4 Logical Framework

| NARRATIVE SUMMARY | OBJECTIVELY VERIFIABLE INDICATORS | | MEANS OF VERIFICATION | IMPORTANT ASSUMPTIONS |
|---|---|---|---|---|
| Inputs Activities and Types of Resources: | Level of Effort/Expenditure for Each Activity: | | | Affecting Input-To-Output Link: |
| | AID $ | GOZ (CPF) | | |
| 1. Program management. 3 L-T PSCs - 15 person years plus local hire staff. | $ 3,400,000 | $ 500,000 | 1. Program management records and reports. | 1. Institutional contractor establishes effective program for policy analysis, program monitoring and evaluation, and policy dialogue in timely fashion. |
| 2. TA for policy reform program/monitoring - 70 person months of studies and S-T TA. | $ 950,000 | $ 500,000 | 2. Project Implementation Reports (PIRs). | 2. Fiduciary bank capable of disbursing funds, securing repayments to CPF, and monitoring transactions. |
| 3. Contract with fiduciary bank for management of lending component. | $ 250,000 | $ 500,000 | | 3. Project Officer and economic research officer have resources to meld all actors into effective program. |
| 4. Commodity imports ($) and commercial bank lending (Z). | $35,000,000 | $13,500,000 | | 4. Commercial banks participate enthusiastically in program. |
| 5. Audits | $ 200,000 | | | |
| 6. Evaluations | $ 200,000 | | | |
| TOTAL | $40,000,000 | $15,000,000 | | |

ANNEX 2

TECHNICAL ANALYSIS

PRIVATE SECTOR SUPPORT PROGRAM -

ANNEX 2

## TECHNICAL ANALYSIS

- PRIVATE SECTOR SUPPORT PROGRAM -

### 2.1. Introduction

The PSSP has two basic objectives.

- o Restructure the zairian commercial banking sector and enable it to support productive investment by medium and smaller-scale enterprises (MSEs).
- o By assisting MSEs, help (1) reverse the decline in industrial production and (2) re-establish demand and supply linkages between urban and rural areas.

This Annex covers the background, rationale, and objectives of the second, or "operational", phase of the PSSP: the provision of foreign exchange for essential private sector imports, and lending of local currency for working capital and local procurement. While the CIP and local currency lending programs described in this Annex are closely related to continuing efforts to obtain macroeconomic and financial system reforms, and are linked to major World Bank and IMF efforts in these areas, the fundamental underlying macroeconomic issues and reform objectives are discussed in detail in Annex 3, Economic Analysis.

The sections which follow summarize the needs of the major beneficiaries of both the CIP and local currency lending programs - small and medium-sized private sector companies - and the operations and constraints of the finance and banking system through which dollar and local currency funds will flow to private sector recipients. This analysis of needs, constraints and opportunities will be followed by a description of how the dollar CIP and local currency needs of the private sector will be addressed and how the two program elements will operate. The Annex concludes by summarizing benefits expected from the dollar and local currency credit programs.

## 2.2 Medium And Small Businesses in Zaire

### (1) Objectives And Methodology

This section of Annex 2 presents the consolidated summary of three interrelated research projects conducted in support of the Private Sector Support Program design.

- "Overview Of the Small And Medium-Sized Private Sector, Survey Of Capital Markets And Financial Intermediaries, And Evaluation Of Training Needs And Resources", Coopers & Lybrand, July 15, 1987.

- "Commercial Trading Enterprises Survey", Coopers & Lybrand, December 15, 1987.

- "Survey Of the Medium-Sized Private Enterprises And Assessment Of Their Financial Needs", Coopers & Lybrand, April 29, 1988.

These reports have been placed on file with USAID/Kinshasa and AID/Washington, and are available for review.

The objective of the research was to provide the necessary understanding and background documentation on the characteristics, operating mode and technical, financial and training constraints and needs facing small and medium sized private enterprises in the manufacturing and production sectors in Zaire.

The field survey, probably one of the most comprehensive of its kind in Africa, covered more than 130 small-sized private manufacturing companies, 80 small-sized trading enterprises in three different regions, and 38 medium-sized manufacturing and commercial enterprises in the capital city of Kinshasa.

The owners or managers of these enterprises were interviewed - in a large number of cases twice - and were encouraged to discuss freely and at length the subjects and problems they deemed important. Their premises were visited and a data collection questionnaire was completed by almost all the persons contacted. Detailed company profiles were prepared for most of the companies included in the sample.

Linkages between the target groups and both the structured and the non-structured financial sectors were reviewed. Interviews were conducted with representatives of the Bank of Zaire, all of the local commercial and the development banks, savings and loans cooperatives, credit unions and private money-lenders.

## (2) Definition Of "Small And Medium Enterprises"

Enterprises of between 10 and approximately 30 employees have, in general, the operating and financial characteristics of non-structured "cottage-industries" and their owners/managers are more craftsmen than entrepreneurs. By contrast, in the 30 to 100 permanent employee range, the companies were found to have all of the fundamental characteristics of formal enterprises.

Similarly, the 100 permanent employee mark defining medium-sized industry appeared to be too restrictive in a situation where labor is cheap and plentiful, mechanization is underdeveloped, and individual productivity is not very high. A number of companies employing between 100 and 500 employees can not reasonably be classified as large companies, if one looks at the complexity of their production process, their organization, management and financial characteristics and their access to financial markets.

It was also found that the small-sized structured enterprises and medium-sized enterprises had so many fundamental management and financial traits in common as to make the distinction between them somewhat meaningless for anything but identification purposes.

The target survey group was accordingly defined as those small- and medium-sized private companies of between 30 and 500 employees.

## (3) Position Of The Manufacturing Activity Within The Overall Economy Of Zaire

Zaire's Gross Domestic Product (GDP) increased by 5.06 % in constant value (base 1970) between 1970 and 1984, while the population increased by 37 percent during the same period, from 21,600,000 to 29,700,000.

Excluding the mining, metallurgical and infrastructure industries which are represented mostly by large parastatals, the industrial sectors of manufacturing and construction show the steepest decrease, both in absolute and relative terms, while the agricultural and services sectors show an increase, both in absolute and relative terms.

Manufacturing represented 6.17 % of the total GDP in 1984, down from 8.02 % in 1970, or a decrease of 19 % in constant terms.

Beverages and chemicals were the only industrial activities to show an increase in constant terms. Tobacco remained constant, jumping from ninth to sixth position while, all other manufacturing activities showed a decrease in constant terms.

Trading, both in imported and local goods, represented 26.77 % of the total in 1984, up from 25.7 % in 1970, or an increase of 11.09 % in constant terms.

## (4) Major Findings Of The Research Conducted Among The Sample Of Small And Medium Industries

An overwhelming percentage of the companies surveyed were experiencing great difficulties at the time of the research. These difficulties arise from the institutional and fiscal environment in which they have to operate, and the present financial and economic conditions of the country.

o Institutional Environment

The general institutional and regulatory environment which small- and medium-sized businesses in Zaire have to operate is common to all categories of private enterprise, whatever their size, location or type of activity. This environment is characterized by:

- A lack of confidence in the politico-economic outlook of the country, both among outside investors and among the locally established business community, and little trust in the civil service.

- Rapid depreciation of the national currency, which influences the companies' abilities to calculate their costs accurately and to adjust their selling price as they renew their inventories. In addition, it reinforces the negative impact of the delay between the production of the goods and their invoicing and the collection of payments by the customer. Commercial credit has, in most cases, disappeared and is replaced by a cash-on-order or cash-on-delivery policy.

- Tightness in the banking market of short-term funds in local currency, and chronic shortage of foreign exchange available to small- and medium-sized private enterprises, due to the Central Bank's monetary policy and those of the commercial banks.

- Direct and indirect taxation which is heavy, ill-suited to the inflationary environment and does not really encourage operations which increase the value added in Zaire.

- Widespread feeling of fiscal and administrative harassment.

- Importance of the parallel economy, especially with regard to the competition that illegal imports represent for locally established manufacturers.

- The fiscal environment does not encourage the conduct of local productive activity. Financial statements of enterprises have become almost meaningless since the fixed assets and the corresponding provision for depreciation and the inventory of goods and parts are not revalued. The operating profit which is calculated is often fictitious and hides the decapitalization, in real terms, of the companies.

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- An indirect taxation, whose major objective should be to encourage the development of the local production of goods through import tariffs and export incentives, but is designed less with this objective in mind than with the short-term maximization of the government's fiscal receipts.

The inefficiency of public corporations constitutes a hindrance to the operation of private economic activities. They are characterized by overstaffing, their civil servants are notoriously underpaid, often poorly qualified and sometimes corrupt.

o <u>Characteristics Of The Companies Surveyed</u>

- <u>Sources Of Supply</u>

  The data clearly show that most companies in the manufacturing sector rely predominantly on imported raw materials and spare parts for lack or unreliability of local sources of supply.

  All companies interviewed stressed that their number one concern was access to additional hard currency, but that better local currency financing was also highly desirable.

- <u>Women As Suppliers And Clients</u>

  There were some instances of important female-owned or operated enterprises as direct clients of the companies surveyed. The percentage was very small and the cases mentioned almost exclusively concerned enterprises which are owned by politically important women. No company interviewed mentioned that they had a female-owned or -operated enterprise as a supplier of raw material, spare parts or other goods or services.

  These findings suggest that when women have their own enterprises in the formal sector they probably operate as traders in the interior rather than in the import-export business or in the industrial sector. Study 8, outlined in Annex 6, <u>Proposed Research, Evaluations and Impact Studies and Human Resources Development</u>, will research further the role of women in the private sector.

- <u>Utilization Rate</u>

  Most companies currently operate at a very low utilization rate, less than 49 % on the average. The main cause of equipment under-utilization is the lack of raw materials needed to operate the existing equipment. The second major cause is the competition from legal or illegal imports, and the third is the reduction in market demand due to the decrease in the population's purchasing power.

## Profitability

Working at low utilization rates, it is likely that most companies operate at, or around, break-even point. The profit figures were consistently extremely low, or in a number of cases, had been negative in 1986 and 1987. Company.representatives expected a worsening of their results for 1988.

## Relationship Between Utilization Rate And Unit Cost

The consequence of working at low utilization rates on unit costs can be dramatic since companies experience difficulties in reducing their fixed costs proportionally with their reduction in output. Consequently, the average break-even point remains high.

Two solutions can be found to counter this phenomenon, both dealing with a reduction in the direct production cost. The best solution is to increase productivity; the second is to decrease the quality of the manufactured products.

In the manufacturing sector of Zaire, where raw materials represent so much higher a cost than personnel in the direct cost of production, a significant increase in productivity can be achieved mainly through investment in better machinery and equipment. The difficult economic and financial situation of a large proportion of the medium-sized industrial companies has, however, limited their willingness, or potential, to invest.

Some companies, reluctantly, have had to have recourse to the second solution of decreasing their direct cost of production so as to keep on operating at, or above, break-even point, and to retain their market volume. Most of these companies have now reached the level at which they have exhausted their "reserve".

## Access To The Banking Sector

Companies in the 30 to 500 employee range had access to the commercial banking system in the forms of overdraft facilities, short-term loans, or other forms of credit. Below the 30 employee level, access was found to be extremely uncommon.

While all companies in the target group had some form of working relationship with banks, the amount of financing they could get was usually totally inadequate, both in terms of working capital and investment financing. The shortage of financing has nothing to do with their "bankability" but is caused by the limited amount of funds which are available for credit through the commercial banking sector, and by the lending policies of the commercial banking sector which are geared towards the large companies, the parastatals, and the import-export businesses.

Marketing Characteristics

A large proportion of the companies suffered from a reduction in sales in constant terms from 1985 to 1987, and all the sectors except plastics were affected. This decrease in sales was primarily due to the difficulty in keeping equipment in operation even though a market for their products existed.

A number of executives stressed the decreasing unit selling price in constant terms of their products which correspond to a switch from high or medium to low quality products to take into account the decreasing purchasing power of their customers. Locally manufactured products must compete with similar imported products on which little or no, import taxes are paid. It is well known that custom tax evasion is carried out on a grand scale.

While the encouragement of the local industry is proclaimed as official policy, the purchasing practices of parastatals which are large purchasers of manufactured goods often favor contracts with foreign suppliers.

Local industries in some sectors, textile and clothing for instance, face competition from foreign manufacturers which dump their low quality or obsolete products on developing countries' markets at the marginal cost of production. Locally produced goods cannot compete on these terms.

Very few industries were found to export their manufactured goods to developed countries or to other neighboring African states.

- Employment

Whereas the average activity of the companies surveyed decreased by 5 %, as measured by sales in constant Zaires, employment increased by 3 % during the same period. This phenomenon can be explained by a number of factors among which:

The strong legal protection employees enjoy under Zaire's labor code.

Salaries are low and represent a small proportion of the total cost of production. This deters employers from rapidly adjusting the level of their work force to current economic conditions.

Companies are reluctant to fire workers and clerks, not to mention foremen and middle-managers they trained on-the-job. The major reason was the fear of not being able to find personnel of similar quality if they needed to increase their work force.

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The manufacturing sector represents a very high percentage of total formal sector employment in the major cities. This is extremely important with regard to social stability because the population growth of the main urban areas in Zaire has been considerable in the past 20 years and shows no sign of abating.

The employment of women was found to be extremely low, less than 4 % of the total employment on the average.

- Ownership Of Capital

All the companies surveyed were locally established under Zaïrian business law. Most of the medium-sized industrial companies are owned by expatriates rather than by Zaïrian nationals. Most, however, have Zaïrian shareholders whose presence has often more to do with their potential of interaction with the authorities than with their real participation in the management of the company.

(5) Major Findings Of The Research Conducted Among The Sample Of Small Trading Companies

The trading enterprises surveyed may be divided into three categories which are characterized by quite different styles of operations.

- Large Trading Companies

This category includes local enterprises of more than 100 permanent employees. They typically have a well established organization, their internal accounts are well kept and their financial management system is sound. These companies usually have a long history of successful operations in Zaire, their stores are well-maintained, and their shelves are well provisioned with a large and diversified inventory.

Large trading companies have relatively easy access to the banking sector and are able to obtain overdraft facilities or letters of credit. The commercial banks provide mainly short-term funds. Most of the medium to long term investments in fixed assets are self-financed.

- The Small And Medium Trading Operations Managed By Expatriates

There are trading enterprises employing less than 100 percent permanent employees belonging to expatriates. They normally operate with less than 30 employees. They present a number of characteristics which make their operating style somewhat similar to the one of the local branches of the large private trading companies.

These commercial enterprises usually trade semi-wholesale and retail in basic manufactured consumer goods and locally produced raw agricultural products cassava, coffee, corn, palm nuts, paddy rice.

Most of these enterprises have access to the banking sector for limited amounts of short-term credit.

## The Zairian-Operated Trading Enterprises

These trading operations could hardly be classified as full enterprises. Their operating characteristics make them closer to "mom and pop shops" and their owners think more like individual artisans than like entrepreneurs. They usually are small, employing on a permanent or temporary basis between 1 and 30 people including the immediate family of the owner-manager.

Most are characterized by:

- Book-keeping in its simplest form and the absence of proper accounting. Most of the owners tend to keep track of cash receipts only and not of their charges. They equate the receipts with their operating profits.

- Lack of proper planning of purchases and of analysis and control of the inventory, resulting in quasi-permanent shortages, lack of variety of products offered and deterioration of goods with a low turnover.

- Confusion between company and family funds.

- Employment of parents or relatives as sellers, either in the shop or on-the-road. There is no serious supervision of them and they often receive no salary.

## Role Of Women In Trade

Although women play an important role in commerce, this role was found to be almost exclusively confined at the lowest end of the scale; i.e., as individuals selling a few products in the market or in the informal sector.

Marketing Characteristics

Trader activity is decreasing in small cities. Traders usually blamed this phenomenon on the quick deterioration of their vehicles resulting from the condition of the roads combined with their inability to obtain the funds needed to purchase new vehicles and spare parts. The reasons set forth by the interviewees, though real, are not sufficient to explain the reduction of activity. Traders have, in the past, faced the same problems.

It is generally recognized that such factors as the improper use of the vehicles, their lack of preventive maintenance, and the careless use of such costly equipment by inadequately trained, motivated and supervised drivers have long existed and resulted in high operating costs. The importance of these costs was long hidden by fat profit margins.

The diminution in the purchasing power of the average consumer in the urban areas, and the disappearance of the "trade quota" system, have been factors which have aggravated the economic environment in which the small-sized traders have been used to operate. A large number were unable to adjust their businesses and practices to new circumstances.

Sources Of Supply

The shops for general trade usually contain all sorts of basic products: food, hygiene, fabric and clothes, small household appliances. They also often offer radios, batteries, flashlights, bicycle spares and repair kits, sometimes cement or corrugated iron. Drugs are only sold in pharmacies.

Traders do not import or export directly the manufacturing or agricultural goods they trade in. They provision themselves, or market the agricultural products through larger companies. Only the urban wholesalers import directly.

There is a strong linkage between trade and agriculture since most merchants interviewed both traded in manufactured goods and in raw agricultural products. A significant number were involved in farming and/or ranching.

Traders' purchases of agricultural products to farmers are, in most cases, made for cash. Barter is practiced on a limited scale.

Traders usually have to purchase their general trade items on a cash basis. Credit has almost disappeared in transactions over the past two to three years because of the high rate of inflation.

Recent Structural Changes In Trade Patterns

Fundamental changes have been taking place in the trade structure in recent years.

Until 1981/83, economic legislation strongly favored trade to the detriment of production activities. Price control mechanisms together with exchange rate distortions tended to keep producer prices and import prices at an unrealistically low level. The result was rationing through quotas of insufficient production and imports to meet excess demand; extensive gray and black markets and an almost absolute lack of competition on the supply-side among traders, importers and producers. Effective consumer prices for unprivileged normal consumers were often 3 to 5 times higher than producer or initial imported prices, and an excessive number of unproductive intermediaries shared the enormous trade margins and benefits.

Since economic liberalization has been applied and demand has been seriously restricted by more severe monetary and credit policies, trade margins have been successfully reduced to almost normal levels in most sectors. Not only did the numerous unproductive intermediaries of the "quota-trade" disappear, but more direct marketing has become a common feature in many traditional trade relations.

More productivity gains will have to be made, however, in the distribution system of manufactured products to counterbalance inflation. While the internal distribution system is becoming leaner and more competitive, much remains to be done at the importers' level.

A great many bottlenecks and inefficiencies in the agricultural and trading systems still remain to be resolved to significantly raise the standard of living in most of the country's rural areas.

- Main Problems Encountered By Traders

Problems in transportation certainly ranked as the number one concern among traders interviewed. Almost universally mentioned were badly deteriorated roads, long transport delays, even when the goods are shipped by air, long waiting lists for railway wagons; theft, not infrequently on a large scale, during transport by truck, railway or at the airport warehouses, road blocks and persistent racketeering by local officials, lack of spare parts for trucks, difficulty in replacing old trucks; and scarce fuel supplies.

In addition to increasing the cost of marketed products, these problems are extremely serious. In the long term, they might cancel the benefits of the agricultural products liberalization policy pursued by the Government, since large quantities of products are wasted for lack of transportation and proper warehousing.

Insufficient working capital and lack of credit ranked second in the traders' preoccupations. The working capital difficulty, in turn, is related to a number of factors: inflation, high percentage of inventory losses and improper pricing methods.

(6) Financing Needs And Resources

o Constraints In Access To Financing

The accessibility of the target group to credit is very limited.

In addition to guarantees or other securities, the banks always base their lending decisions on an evaluation of the companies' financial data. Both these requirements effectively leave little chance for the smallest entrepreneurs to be considered "bankable".

Security in the form of a mortgage on the business property is almost meaningless for bankers. Firstly, the real market value of a store, or even a house, in the small towns is very low and, second, banks are usually unable to effectively acquire ownership of the mortgaged property in the case of default.

With respect to financial statements, most small enterprises, and a number of medium-sized ones, keep two sets of accounts, one for official or fiscal use an the other for the owner's eyes only. The former are not even considered by the banks and they tend to view the latter with deep misgivings.

Some small businessmen deliberately do not want to ask for credit because they are afraid of banks. Companies above the 30 employees level, however, were found to be able to meet the lending conditions required by the commercial banks. Shortage of credit supply, not "bankability" is the major constraint.

With a strictly limited supply of funds, the market for loans is a suppliers' market. Consequently, commercial banks have little incentive to reach the more risky and more costly segment of the market. Banks are apparently satisfied to limit their actions to customers such as the large private companies and the parastatals, and to restrict their services to the safest ones in providing overdrafts and documentary credits.

It is clear that the root of the problem remains the availability of hard and local currency funds available for credit.

- General Characteristics Of The Financial Intermediaries Sector As It Relates To MSE Financing

The credit controls in force determine the type and volume of operations undertaken by the commercial banks. Such controls do not affect the development banks. The lending policies of the latter are based on the availability of funds and whether the projects qualify or not for lending.

The commercial banks lend short-term, but such credits are limited overall by the credit ceilings. Of the short-term credits available, only a minimum amount goes to the MSEs.

Credit Unions generally offer short-term consumer credit only to their members. While they collect large amounts of deposits, a number of studies have demonstrated their inadequate management capacity.

SOFIDE, the largest of the two development banks, offers medium- and long-term funds for investment and approximately 60 % of such funds are made to the MSEs. Loans are generally made in foreign currency and the repayments are calculated on the foreign denominated debt. Because of the weak Zaire currency, the effective repayment cost has become prohibitive for most present and potential borrowers.

Commercial banks' medium and long term credit is extremely limited. The economy and market forces are such that banks do not have the interest and ability to attract, and consequently to lend, these kind of funds.

- Allocation Of Foreign Currency Resources

The foreign currency resources currently transiting via the commercial banks is at the level of U.S.$ 550 - $ 600 million per year. This amount includes World Bank and other grants and loans made to the GOS but excludes Gécamines and petroleum export revenues which are directly taken up by the Bank of Zaire.

In addition to the resources deployed by the commercial banks, an estimated U.S.$ 200 to $ 400 million is handled by the parallel market each year. This amount obviously fluctuates and increases particularly when the differential between the official and parallel rate is significant. At the time of the study, the differential had been no less than 25 % for a number of months.

The commercial banks allocate their hard currency in roughly the following order:

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Petroleum products imports: 30-40 %, Multinationals, large companies in all sectors, parastatals: 30-50 %. Medium and small-sized (bankable) companies: 10-20 %.

Of the 10-20 % level reserved for the MSEs in the official financial system, traders and industrial companies have an even share of this allocation. The amount estimated to be available for these enterprises is now on the order of U.S.$ 60 to 120 million per year. Probably a maximum of 50% of this amount goes to the manufacturing sector, or in the range of U.S. $30 to 60 million per year.

Financing in local currency, while less problematic than financing in hard currency, is still well below needs. The credit policies of the Central Bank are very restrictive and companies experience severe cash flow problems because they have to deposit the counterpart value of 100 % of the amount of their letters of credit when these are opened.

It is very important to note that almost all companies have had to abandon any form of customer credit to mobilize the financing they need for local currency operating funds.

- Estimate Of Working Capital Financing Needs

Short-term foreign currency financing needs of the medium-sized companies in Zaire, which are not presently available through the banking system, are in the range of $60 and $100 million a year. The need for local currency financing of the small and medium-sized companies in Zaire is roughly estimated at 2.2 billion zaires annually, or around U.S.$ 18 million in 1987.

- Investment Financing Needs

Net private transfers have been deteriorating since 1983 in such a proportion that the net public transfers have not been able to compensate for the fall. They have consistently been negative for the past three years which might indicate how little new private foreign investment has been realized during the period.

Since very little medium- to long-term financing can be obtained through the commercial banks, or currently through SOFIDE, which presently experiences a difficult financial situation, the investment financing gap is estimated at approximately U.S. $12 million equivalent for the 38 medium enterprises surveyed, a large proportion of which would require foreign currency. This gap represents the level of desired funding needed by the MSEs surveyed for projects they are already contemplating.

(7) Recommendations

- Major Difficulties of MSEs

Small and medium sized private enterprises face major problems which are listed in decreasing order of priority.

- The cost and/or unavailability of inputs for production because of a shortage of foreign exchange and lack of working capital. This problem is absolutely general and constitutes the primary constraint.

- The cost and/or unfeasibility of extending distributor credit, because of rapid monetary depreciation and inadequate outside financing for working capital. This affects market demand.

- The age and poor condition of the productive equipment, because of a shortage of hard currency for purchase of spare parts and of medium and long term financing for rehabilitation or modernization of the equipment.

- The burden that receivables represent for those companies dealing with government agencies and parastatals.

- The absence of a systematic or efficient program of local purchases by the parastatals.

- The lack of an adapted financial training program. To be really helpful, and appealing to the targeted population, the training would have to be very practical and directly applicable by the entrepreneurs in the day-to-day management of their companies. The managers of small- and medium-sized companies need management tools rather than general management concepts and principles.

All companies interviewed insisted that what they need most at this time is working capital and better access to foreign exchange. Given this kind of assistance, a large number declared that they could tackle most of their other problems.

- Criteria For Success In Implementing An Assistance Package

Most MSE managers think that donor agencies have not demonstrated any real interest in small, private industry. Entrepreneurs estimate that financial assistance has, almost always, been directed towards the agricultural sector, the parastatals and government organizations.

To ensure success of the private sector project, three major conditions appear to be essential :

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Build up confidence in the ability of donor agencies to deliver quickly an assistance package tailored to the needs expressed by the intended beneficiaries themselves.

Implement a flexible project structure operated by experienced managers with enough authority to answer industrialists' real needs.

Do not involve a government agency in the management of the project and of its funds.

(8) Conclusion

The research clearly illustrates the extremely difficult situation that small and medium sized private companies have been experiencing for the past two years.

The lack of financing, especially the shortage of foreign exchange, the macroeconomic monetary policies, and the commercial banking sector's attitude towards the small and medium-sized manufacturing sector are major constraints hampering the development, and even endangering the survival, of these companies.

## 2.3 The Financial Sector - An Overview

### (1) Financial Sector Institutions

1. The Central Bank

The Bank of Zaire is Zaire's central bank and performs all the normal functions of a central bank such as monitoring financial institutions, administering national monetary and credit policies and managing international reserves. The Bank is headed by a Governor and a Vice-Governor, appointed by the President. Its day-to-day operational chief is the Managing Director, a position currently filled by a staff member of the IMF on secondment. The Bank has about 2,000 employees and a number of regional offices.

The Bank of Zaire supplies certain banking services to the GOZ and parastatals, such as making advances to the Treasury, managing issues of Treasury bonds, managing the printing of currency notes, buying for local currency the 55 percent of Gecamines' export receipts that Gecamines does not retain, receiving royalties in foreign exchange from exporters of crude oil, handling transactions with the IMF, selling the Treasury foreign exchange as required.

The Bank of Zaire also makes substantial advances to the commercial banks, especially since 1986. Based on its balance sheet shown in Exhibit 2.2, below, interest income from advances to banks in 1987 at 25 percent must have been more than twice the interest income from the GOZ at 4 percent.

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In addition to monetary policy, the Bank of Zaire has ample authority through the Banking Act to control and regulate bank and non-bank financial institutions and to approve the establishment of new financial institutions. However, the Bank of Zaire does not always use its full regulatory powers in its interaction with the financial institutions. Instead, it has concentrated on establishing credit ceilings, setting reserve requirements, and establishing limits on the commercial banks' foreign exchange holdings, as discussed below. As a result, bank and non-bank financial institutions have developed in a largely unregulated and laissez-faire environment.

Fortunately, seven out of the nine commercial banks established in Zaire are either branches, affiliates or subsidiaries of major foreign banks, and therefore operate according to the internal norms and control standards imposed on them by their respective parent organizations. One of the major local banks (BZCE) has no current foreign affiliation (100 percent owned by the GOZ) but was originally an affiliate of the Bank of America. It continues to be run very much as a private commercial bank, due mainly to the fact that it has maintained the staff and the internal procedures developed by Bank of America.

This partially explains why there have been no bank failures in Zaire, with the exception of the then 100 percent locally-owned Bank of Kinshasa, which declared bankruptcy in 1986 and has since been taken over by the GOZ. Nonetheless, there is a need to develop and implement a simple and clear regulatory framework but to create tools and instruments to implement its provisions. This is discussed below in the section on the ongoing financial sector development program.

2. Commercial Banks

The consolidated balance sheet of the commercial banking system is shown in Exhibit 2.2 in nominal terms, while the trends in bank credit and deposit taking are shown net of the impact of inflation in Exhibits 2.3 and 2.4.

There are nine commercial banks in Zaire:

--- BCZ: Banque Commerciale Zaïroise

--- UZB: Union Zaïroise de Banques

--- BZCE: Banque Zaïroise du Commerce Extérieur (ex-Banque du Peuple, ex-Société Congolaise de Banques)

--- NBK: La Nouvelle Banque de Kinshasa (ex-Banque de Kinshasa)

--- Citibank

--- Barclays Bank

--- BACAZ: Banque Continentale Africaine au Zaïre

--- BIAZ: Banque Internationale pour l'Afrique au Zaïre

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The three major banks, BCZ, UZB, and BZCE, hold 75 percent of total commercial banking assets. BCZ and UZB are privately owned whereas BZCE is owned and controlled by the GOZ. The only other GOZ-owned commercial bank is NBK, which was declared bankrupt in 1986 but is currently being kept alive artificially by heavy cash injections from the Bank of Zaire. The remaining five banks are either branches or subsidiaries of foreign banks. They have branches only in Kinshasa (except for BIAZ which has a small branch in Shaba), and have only 12 percent of the market.

The soundness of a banking system is measured in terms of its liquidity, profitability and the quality of its loan portfolio. The Bank of Zaire acts as the lender of first resort to the banking system through its money market facility. The banks are thus able to borrow from the Bank of Zaire through the money market window to cover their needs. For this reason, the banking system in Zaire may be considered liquid with exception of the NBK, a GOZ-owned commercial bank which was declared bankrupt in 1983. For the most part commercial banks in Zaire are sound.

Applying normally accepted measures of bank capitalization, such as capital to total assets, the commercial banks are undercapitalized. The average level of capitalization for most commercial banks in Zaire measured in terms of capital to total assets, which is below 1 percent, is much less, for example, than in the much more secure environment of the United States where this ratio is 6.5 percent. The level of capitalization is important since it helps the bank withstand potential losses from non-performing assets.

All branches and affiliates of foreign banks operating in Zaire, however, have access to a wide and strong capital base of their parent organizations. The undercapitalization with respect to foreign banks' branches in Zaire, therefore, is to some extent an artificial problem. The publicly owned BZCE is capitalized at 5 percent which is not adequate but nevertheless is high compared to the foreign owned banks.

3. Development Banks

There are two development banks in Zaire: SOFIDE and the Agricultural Credit Bank (BCA).

o SOFIDE

The Société Financière de Développement (SOFIDE) was established as a limited liability company in 1970 with 40 percent GOZ and 60 percent private participation, including 18.75 percent subscribed by the IFC. SOFIDE's original purpose was to foster the development of a domestic capital market and to finance investments in productive sectors. Today it is the main term lending institution in Zaire and the only non-government source of investment capital and credit for the private sector. Although historically concentrating on rehabilitation and modernization of existing industrial capacity and agricultural and transport projects, SOFIDE has recently increased financing of small and medium enterprises.

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SOFIDE is by far the larger of the two development banks with a total portfolio of 6.6 billion zaires compared with 0.2 billion zaires for the BCA at the end of 1986.

SOFIDE is funded almost entirely from external long term loans provided by the World Bank group and other international institutions. Since foreign exchange risks are passed on to the borrower, the constant depreciation of the local currency has resulted in high levels of unpaid loans due to the exchange rate burden. The GOZ has established an exchange risk guarantee scheme for SOFIDE's loans to address this problem, but the program is not operational. Given the financial burdens such a scheme could entail, the World Bank has recommended that it be limited to MSEs if eventually it becomes active.

o The Agricultural Credit Bank (BCA)

The Banque de Credit Agricole (BCA) was created by the GOZ in 1982 to provide credit to small and medium size farmers and small agribusinesses. The BCA is both a development and a commercial bank. As a commercial bank, it collects deposits from the public, extends commercial loans and is subject to credit ceilings. As a development bank, it funds itself from external sources and makes medium to relatively long term loans outside the ceilings.

The BCA is currently suffering from the lack of deposits to expand its portfolio. It has, up to the present, depended mainly on the GOZ for both capital and deposits. However, it is expected that the GOZ will soon open the BCA's capital base to outside sources, which will allow the BCA to offer shares to international institutions. With an increased capital base, the BCA will probably open new branches to expand both deposit-taking and credit operations.

4. Non-Bank Financial Institutions

The formal sector of the non-bank financial system comprises the following institutions.

- --- SONAS: State owned insurance monopoly.
- --- CADEZA: A public savings institution.
- --- CCP: A GOZ postal savings entity.
- --- INSS: The social security fund.
- --- MOBIMO: A subsidiary of a commercial bank, specializing in construction and real estate financing.
- --- COFIKI: Also a subsidiary of a commercial bank, specializing in construction and real estate financing.

Most of these institutions are GOZ owned, poorly managed, undercapitalized and overstaffed. If rehabilitated, it is possible that they could play a major role in mobilization of savings and in channelling savings into productive use through the lending institutions. Their current condition is such, however, that rehabilitation would be a long-term process.

The informal non-bank financial sector comprises several institutions established by community-based organizations and religious groups. The most important are the Saving and Credit Cooperatives (COOPECs). The COOPECs are very simple grass-roots organizations whose main activity is safeguarding savings for their members. To date, COOPECs do little lending, depositing instead their free cash with their regional apex organizations, the COOCECs. Some of these funds are ultimately invested in Treasury bonds, but accounting and control mechanisms are very weak at both the grass-roots and regional levels.

The grass-roots COOPECs are totally unregulated and the absence of any real competition from the banks has allowed them to expand rapidly in the last few years. By the end of 1987, COOPECs had mobilized an estimated 1.5 billion zaires in savings deposits, or 7 percent of commercial banks' deposits. Because of their growing importance, the GOZ will soon introduce a law regulating the the cooperative financial institutions.

(2) Financial Markets

1. The Money Market

o Money Supply

The financial sector in Zaire is characterized by a rapid growth in money supply over the last five years. M1* grew from Z 13 billion in 1983 to Z 57 billion in 1987 representing an increase of 430 percent over that period. M2* on the other hand, grew almost at the same proportions during the same period: Z 14 billion in 1983 to Z 60 billion in 1987.

The major component of M1 is the fiduciary currency circulating informally outside the banking sector. The fiduciary money, as a percentage of M1, grew faster than the growth in M1 itself.

This phenomenon reflects on one hand the failure of the banking system to mobilize the financial resources being released by the central bank and on the other hand the ability of the informal sector to suck and retain liquidity.

The holding of liquidity by the public outside the banking system was exacerbated in 1983 when a major commercial bank became illiquid and unable to meet withdrawals. The confidence in the banking system was severely undermined and the public further held onto its cash rather than depositing it into the banks. The Central Bank was therefore obliged to pump more liquidity into the banking system in order to keep up with the demand for withdrawals. This explains not only the relative importance of the fiduciary currency outside the banking system but also its causes and origins.

As mentioned earlier, the over-liquid nature of the Zairian money supply reflects the banking system's inability to mobilize deposits and the relative strength of the informal sector in retaining liquidity.

It is estimated that one out of two Zaires issued by the Central Bank circulates and remains outside the banking system. In addition to the institutional causes identified above, there are socio-economic elements that further influence the retention of cash by the informal sector; i.e., a cash economy where most payments such as salaries and business transactions are settled in cash, lack of an adequate branch banking network, and the psychological security and the social habit of holding cash.

The failure of the commercial banks to mobilize deposits and the relative strength of the informal sector to hold onto it, make it doubly difficult for the Central Bank to pursue and implement an efficient monetary policy and to fight inflation. As long as the Central Bank acts as the lender of first resort, there is no incentive for the commercial banks to go out of their way to mobilize needed resources. The fiduciary portion of the money supply, therefore, serves to fuel permanent and structural inflation.

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*M1: currency in circulation plus current account deposits in banks and non-bank financial institutions.

**M2: Term deposits.

Several attempts have been made by the monetary authorities in the past to solve the excess liquidity problem in Zaire — without much success. For instance, in 1984, BDZ decided to demonetize the Zaire currency by destroying all existing bank notes and replacing them with new ones. This measure traumatized the population and probably contributed to the dismissal of the Central Bank Governor. The second attempt to draw liquidity from the public's hands was through the issuance of Treasury Bills.

In the words of one monetary expert, the excessive liquidity problem in Zaire can only be solved within the context of intermediation by the financial institutions, changes in the method by which the GOZ finances its budgetary deficit, and the creation of viable monetary instruments.

o Bank Credit

The aggregated balance sheet of the commercial banks is shown in Exhibit 2.2, below. The bulk of commercial banking deposits are in the form of short term, non-interest bearing demand deposits. These resources are used to finance short term needs of borrowers - short term loans of less than one year and overdrafts.

Commercial bank lending rates were 32-46 percent in 1987 and 45-53 percent in early 1988, corresponding to the marginal cost of funds from the Bank of Zaire's money market window of 25 percent in 1987 and 35 percent after March, 1988. All these rates are far below the 100 percent rate of inflation experienced since the beginning of 1987. Although lending rates are free to fluctuate, it is also reported that informal political pressure would be exerted if the rates went higher.

The banks' preference for short term lending is due to several factors.

(1) Lack of Long Term Resources: The bank's resources are primarily in the form of short term demand deposits. The bulk of the cash being deposited into the banking system is in the form of cash cover for import Letters of Credit. It is highly unlikely that banks could loan long term with short term resources. Such mismatching of funds, which is contrary to sound banking practice, would be very risky and would undeniably have serious and negative effects on the stability of the banking industry as a whole.

(2) Lucrative Non-Credit Business: While banks break even on credit transactions, their real profits are derived from the commission income generated by import letters of credit, foreign exchange transactions and other related services such as currency transfers and issuance of guarantees. In other words, the commercial banks in Zaire are making their living mainly by recycling the foreign exchange that comes into the country as export proceeds, or as inward transfers, including foreign currency loans from the multinational agencies, and various grants from the donor community.

o Regulation of Credit

The Bank of Zaire has the primary responsibility for containing inflation through monetary and credit policies. The following policy instruments are currently used for this purpose.

a. Credit Ceilings

Credit ceilings are used by the Bank of Zaire to limit overall bank overdrafts and loans. The overall national ceilings for the country are established quarterly by the Bank of Zaire in consultation with the IMF. Each commercial bank is allotted a share of the total based on their individual capital base and deposits. Excluded from credit ceilings are transactions that do not result in cash disbursements by the banks, as well as contingent liabilities such as letters of credit, guarantees, and forward exchange transactions.

At the end of 1987, most banks had fully utilized their ceilings. The Bank of Zaire is under strong pressure from IMF not to increase ceilings for the purpose of accommodating a particular project as this would defeat the purpose of controlling the credit expansion, although the availability of external financing is taken into account when the overall ceilings are established each year. Unfortunately for the banks, a one dollar increase in external resources does not necessarily result in a one dollar increase in credit ceilings. In discussions regarding the PSSP, the IMF has agreed to take the project's foreign exchange and local currency lending activities into account in establishing credit ceilings with the GOZ.

b. Reserve Requirements

This instrument is used by the Bank of Zaire to sponge off excess liquidity from the banking system. Since May 2, 1988, the reserve requirement coefficient stands at 50 percent on total deposits and current account balances of less than six months, provisions made for letters of credit and other payables, and 100 percent of the counterpart funds accounts in commercial banks.

The balances held by the Bank of Zaire in the form of the reserve requirement are not remunerated, exept for a portion in the form of Treasury bills paying 8 to 10 percent.

c. The Money Market Window

All commercial banks are structurally short of liquidity, largely due to high reserve requirements. Interbank lending is practically non-existent since all banks are in the same position. When additional liquidity is needed, commercial banks turn to the Bank of Zaire's money market window for funding because of its relatively low rate (35 percent since March, 1987) and easy access (no predetermined limits). Banks had borrowed 15 billion zaires from the Bank of Zaire at the end of 1987, versus reserves held in the Bank of Zaire of 27 billion (see Exhibit 2.2).

Since banks are able to cover all their incremental funding needs through this mechanism at an interest rate of 35 percent, there is no incentive for the banks to mobilize additional resources from depositors. Therefore, the rates charged by the Bank of Zaire constitute, for all practical purposes, the cost of funds to the banks.

d. Rediscount Facilities

Banks also have access to the rediscount facility for short term rediscounting of commercial paper at the rate of 37 percent. The overall country credit limit set by Bank of Zaire at the end of 1987 was 5 billion zaires for this facility. Each bank is therefore allotted a share proportional to its credit ceilings. Since the money market facility is cheaper, banks are not using the rediscount facility.

e. Interest Rates

Between 1981 and 1983, interest rates were liberalized and set free to fluctuate, with the exception of rates on loans for non-coffee agriculture, which were held to 22 percent while other rates rose to the mid 30s. Agricultural loan rates were finally liberalized in September, 1987.

The following interest rates on GOZ transactions are still set by the Bank of Zaire:

--- The rate of 4 percent which the Bank of Zaire charges GOZ Treasury for advances;

--- The money market rate of 35 percent charged by the Bank of Zaire to the banks;

--- The rediscount rate of 37 percent for the rediscounting of short term commercial paper at the Bank of Zaire's window by commercial banks;

--- The rate on unsecured advance by the Bank of Zaire to commercial banks of 39 percent; and

--- The Treasury bill rate to the public ranging from 34 to 45 percent for 28 to 182-day placements, respectively.

o Mobilization of Resources

The commercial banks' mobilization of deposits is shown in Exhibits 2.2 and 2.3. Current account deposits are remunerated at 0.5 percent, and time deposits are currently earning 3.25 to 33 percent. Deposit rates have remained inflexible, despite inflation and the competition of Treasury bills introduced in 1984. Since banks have the Bank of Zaire's money market rate (currently 35 percent) as an alternative, they are not willing to remunerate term deposits at higher rates.

Banks' ability to mobilize both short and long term deposits is also greatly hampered by rigid requirements for opening bank accounts, high service and transaction charges, and the lack of foreign exchange, which attracts local currency deposits to pay for letters of credit.

Furthermore, the banks' incentives to mobilize deposits from the public are weakened by the 50 percent reserve requirement, the lack of remuneration of reserves, the presumed weakness of demand for loans at high interest rates, and since 1986 the easy availability of funds from the Bank of Zaire at relatively low interest rates.

It is generally accepted that Zaire is underbanked in relation to its size and its economic and business potential. Total commercial bank lending stood at 25.5 billion zaires at the end of 1987, or about $125 million. In comparison, Senegal, with one-third Zaire's GDP, has nearly twice that volume of total bank lending. Furthermore, Zaire has only about the same number of bank branches as does Senegal (about 100), despite being about ten times Senegal's physical size and having a deteriorated internal transportation system.

2. The Foreign Exchange Market

The Balance of Payments tables (see Exhibit 2.5) show the flows of foreign exchange through official channels: principally the overseas accounts of the Bank of Zaire, the commercial banks, Gecamines, and the petroleum exporters. Although no institutional flow of funds matrix exists for Zaire, information available show that the Balance of Payments include flows through the foreign exchange accounts of the Bank of Zaire ($744 million in 1987, including foreign exchange ceded by Gecamines, royalties from oil producers, and IMF loans), foreign exchange retained in foreign accounts by Gecamines (45 percent of receipts, or about $417 million in 1987) and by the oil exporting companies (about $134 million in 1987), debt relief ($730 million in 1987 in the form of a capital transaction, rather than cash), and some foreign assistance disbursed from offshore accounts (e.g., USAID's CIPs and PL-480 import financing).

The commercial banks receive foreign exchange from exporters of diamonds, agricultural commodities, and miscellaneous manufactures, as well as inflows from embassies, missionaries, and others. The value of import letters of credit opened by the commercial banks in 1987 from these sources has been estimated at only $550-600 million.

The Bank of Zaire does not open letters of credit for private customers, nor do commercial banks sell foreign exchange to the GOZ or the Bank of Zaire. Thus, except for net sales by the Bank of Zaire to the commercial banks ($42 million in 1987), the public sector and private sector financial circuits for foreign exchange remain separate.

In addition to the flows represented in the official Balance of Payments tables, substantial sums in foreign exchange are also traded through the "parallel" market. Parallel market transactions are effected directly between the foreign bank accounts of private parties, without passing through the accounts of the Bank of Zaire or the commercial banks.

Since most private capital outflows require prior approval from the Bank of Zaire, the parallel market can sometimes be the only practical way to transfer funds out of Zaire. Furthermore, a difference of more than 10 percent between the bank rate and the parallel rate is thought to trigger sizeable shifts of export receipts from diamonds, gold, and coffee to the parallel market.

Since October, 1986, commercial bank exchange rates have been set by the Bank of Zaire, which allows commercial banks to price foreign exchange only one or two percent above the central bank's official rate, which is pegged weekly. In 1987, central bank rate fixings lagged behind the parallel rate notably in the early part of the year (about 20 percent undervalued relative to the parallel market) and again in December (about 25 percent undervalued). (See Exhibit 2.6)

Partly stimulated by this slight undervaluation of foreign exchange at the banks, total sales on the parallel market appear to have grown in 1987. One estimate of 1987 sales on the parallel market was $200 million. However, hard data are lacking since the parallel market, while not actively suppressed, is officially illegal. The portion of sales on the parallel market used for imports as opposed to outward transfers is unknown, as is the possible amount of export receipts that are not officially registered and that do not return to Zaire as imports or through sales on the parallel market.

Furthermore, because of administrative weakness and individuals' preference for avoiding restrictions, it is likely that a substantial amount of international trade takes place in various parts of the country (the extreme northeast and the extreme southeast, for example) without any involvement of official financial institutions or even the Kinshasa parallel market.

3. The Government Securities Market

The GOZ's financing needs are essentially met by advances from the Bank of Zaire at 4 percent interest: see Exhibit 2.7. Treasury bonds, one series paying 3 to 10 percent available to banks, another series paying 34 to 45 percent (depending on term to maturity) available to individuals, play a limited role, as do "lottery securities", which are GOZ lottery tickets that bear a low interest rate.

The GOZ's key concern in financing the deficit has been to minimize the cost to the Treasury. As a result, market-priced Treasury bonds have been offered sparingly; the total outstanding on March 31, 1988 was 6 billion zaires, compared to 33 billion zaires outstanding from the Bank of Zaire to the GOZ at 4 percent.

The new Treasury bills that are currently in circulation were launched in 1984 to meet three distinct objectives:

— To sponge off the excess liquidity from the public;

— To raise the level of interest on deposits by offering rates higher than the bank's deposit rates; and

--- To finance the GOZ deficit.

Treasury bills carry one to six month maturities. The subscription amount is paid at the face value minus interest, while at maturity the bills are redeemed at the full face value. The resulting interest is tax free. There is no secondary market for these instruments.

The issuance of Treasury bills has not significantly reduced liquidity held by the public. On the contrary, the balance between the new issues and the redemption of the old has been very low, at times negative. In other words, the GOZ Treasury has been from time to time paying more to the public in the form of the redemption of the outstanding Treasury bills than it has been able to take in new issues.

Commercial banks are not allowed to purchase the new Treasury bills although some banks are still carrying in their portfolios a small amount of old Treasury bills issued before 1984, which banks were allowed to purchase.

The year 1987 marked a new departure in deficit financing, as the counterpart of "policy-based loans" (PBLs), principally the World Bank's SAL, were used as budgetary support for the GOZ, with the proviso, however, that this support substitute for financing from the Bank of Zaire, rather than add to it. On the assumption that the GOZ would meet its spending and revenue targets, this would have allowed the GOZ to reduce its debt to the Bank of Zaire by 9 billion zaires in 1987, which allowed the administrative ceiling for bank credit to the private sector to rise by 13 billion zaires, an increase of 116 percent.

In fact, fiscal targets were not met and GOZ borrowing from the Bank of Zaire continued to rise at the same time that the ambitious target for credit to the private sector was fulfilled (in nominal terms), resulting in a massive increase in the money supply (see Exhibit 2.1).

## (3) Evolution Of Financial Sector Reforms

### 1. The IMF's Stand-By Programs

The IMF's Stand-By Programs have since 1975 consistently promoted greater fiscal control and reduced deficits, market-based pricing of foreign exchange and local currency credit, and abolition of quantitative restrictions on trade. In addition, as the IMF moves to longer-term programs under the SAF, it will increasingly support indirect mechanisms for control of domestic liquidity (control over the monetary base through open-market, required reserve, and discount policies), in place of the direct mechanisms in use now (credit ceilings). The SAF will continue to emphasize the need to reduce inflation, which will raise real interest rates and increase the efficiency of resource allocation.

## 2. The World Bank's Structural Adjustment Credits

The first SAL contained a financial sector element which initiated discussions in the area of credit policy. Under this program, the requirement for prior Bank of Zaire approval of agricultural and medium term loans was eliminated, agricultural interest rates were freed from control, allocation of credit ceilings was streamlined, and the turnover tax on banks' interest earnings was eliminated. Some progress was also made in discussing agricultural credit policy, regulating credit cooperatives, and improving regulation of commercial banks. At the same time, the GOZ created a floor (minimum lending volume) for agricultural credit for each bank.

Financial sector reforms are to be expanded in 1988 through the FSAC. The overall objectives of the FSAC are to substitute indirect for direct regulation of the financial sector, to improve the mobilization of resources and to increase the availability of credit. The priority measures taken will be to improve control over the money supply and the working of credit and financial markets. Secondly, measures will be considered to improve the policies followed by the commercial banks and other credit institutions concerning credit allocation, interest rates, and financial intermediation. In addition, several financial institutions urgently need rehabilitation measures. Finally, some reform in financial regulations will be proposed to support the restructuring planned under other measures.

The major measures that have been discussed in the context of the FSAC are the following.

- Strengthening the Money Market

To make the current money market a true vehicle for mobilization and allocation of financial resources at market equilibrium interest rates, measures have been discussed to reform the Bank of Zaire's intervention in the market by raising the real rate of interest and limiting the volume of lending. The 10 percentage point increase in the Bank's money market rate that occurred in March was a response to this discussion. Furthermore, ways to involve other institutional investors in the money market will be investigated.

- Interest Rate Reform

While market interest rates are to be brought to positive levels, the structure of official interest rates also needs to be rationalized. In particular, the existing gap between low rates and high rates on different series of Treasury bills needs to be narrowed.

- Required Reserves

To reduce the disincentives for savings mobilization, the GOZ will study elimination of the reserve requirement for all term deposits.

o <u>Improved Bank Supervision</u>

- <u>Debt Equity Ratios</u>

The low rate of capitalization of most banks established in Zaire makes it imperative to directly link banks' indebtedness to their capital base. Operationally, most commercial bank branches are subsidiaries of foreign banks, but legally they are local entities incorporated in Zaire. Therefore they should be required to meet a minimum capital requirement.

- <u>Minimum Capital Requirements</u>

The Banking Act sets the minimum capital requirement of 250,000 zaires. When this figure was established, the exchange rate was 1 zaire = $2.00 and $500,000 was considered adequate capitalization. Currently, the Bank of Zaire requests new banks to invest a minimum of SDR 4 million. This new requirement needs to be formalized, the Banking Act amended and the existing banks requested to adjust their capital base accordingly.

- <u>Limit On Non-Fund Commitments</u>

These so-called off-balance sheet, fee based transactions such as letters of credit, guarantees and forward foreign exchange transactions constitute the main source of income for the banks. They are a real risk for the banks and although they do not affect credit ceilings, their magnitude should be limited without impairing the ability of the banking system to finance import/export activities. A limit is being proposed under the current World Bank program.

- <u>Audit Requirements</u>

Although banks are required by the Banking Act to have their books audited at least once a year and the audit statements published, some banks, especially the state-owned banks and all the non-bank financial institutions, do not always conform to this requirement. This exposes the banking system to a great danger and does not provide the Bank of Zaire with a warning system against the eventuality of bank failures. A new "Asset-Liability Situation" form is being introduced to supplement the accounting procedures manual for all banks.

- <u>Inspection and the Information Flow</u>

The inspection efforts of the Bank of Zaire need to be strengthened so as to closely monitor the application of the banking regulations and to preserve the banks' solvency and stability. The strengthening of the banking system also requires an accurate and timely flow of information in a two way fashion from Bank of Zaire to the banks and vice versa. Two international experts will soon join the appropriate office in the Bank of Zaire.

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- Cooperative Savings Associations

A new law governing COOPECs is being drafted.

o Institutional Restructuring

- NBK

A determination is to be made on the liquidation, privatization, or restructuring of the NBK.

- BCA

A decree will change the statutes of the BCA, the agricultural bank, to permit it to open up its capital to non-government investors including international institutions.

- SONAS

The elimination of SONAS' monopoly of insurance is under discussion, along with measures to improve SONAS' own operations.

(4) Conclusion

The financial sector in Zaire is undergoing a period of uncertainty and scarcity of banking services due to the overall negative macroeconomic outlook: high GOZ deficit, high inflation rate, constant depreciation of the currency, diminishing purchasing power and lack of credit ceilings and high reserve requirements - this environment has forced the commercial banks to become highly risk averse and to concentrate on the recycling of the small amount of foreign currency that is still available. Banks, in other words, prefer to concentrate on non-fund activities with high rate of return and low risk such as letters of credit, currency transfers, exchange transactions and the issuance of guarantees.

The PSSP has therefore been designed to help alleviate some of these problems through its recommended policy reform program. The first set of reforms aims at improving the overall macroeconomic situation of the country whereas the second portion of the policy reform is directed at furnishing ways and means to induce financial institutions to mobilize additional resources and at the same time increase their level of financial intermediation (see Section 6, Conditions and Covenants, for the recommended reform agenda and the following Annex 3, Economic and Financial Analysis, for more discussion).).

## 2.4 Key Benefits and Major Beneficiaries

The Republic of Zaire is currently experiencing an acute foreign exchange shortage. The country's total annual external payment bill amounts to $ 3 billion whereas the export proceeds are estimated at $ 1.3 billion. The gap must be covered through various foreign assistance programs and from the inward transfers of invisibles.

The private sector, especially the manufacturing and the processing sub-sectors is the segment of the Zairian economy most affected by the foreign exchange shortage due to its heavy reliance on imported raw materials and spare parts. The shortage of foreign exchange coupled with the declining purchasing power of the population and the lack of bank term credit have forced the industrial sector the operate at 30 -40 percent capacity. The PSSP is therefore designed to inject financial resources into the banking system so that it can increase its level of financial intermediation towards the private enterprises, especially the industrial sector and thereby allow the industrial sector to increase its capacity utilization.

The Major Beneficiaries Are:

The GOZ: The $35 million Credit Fund will serve as a balance of payment support during the three-year period to the Republic of Zaire. Further, the local currency equivalent of $10-13 million representing the required 25 percent will be provided by the CPF therefore the GOZ Treasury will not have to provide this amount from a direct budgetary allocation. This source of financing is much less inflationary than GOZ borrowing from the Central Bank.

The Banks And The Financial Sector: Banks will increase their risk assets portfolio by the amount of loans being provided under this project. More importantly, banks will start extending badly needed medium term credit to the private sector. They will at the same time increase their earning power through the commissions on the letters of credit and guarantees. The reform program, on the other hand, will induce the financial institutions to mobilize more resources, increase their level of financial intermediation and improve the quality of their services.

The Private Sector: Will have access to foreign currency with which to finance its basic imports. Local currency loans in the form of both short and medium term credit will finance local purchases. The injection of the new resources should help the industrial sector increase its productive capacity and thereby increase the level of import substitutions.

The Absence Of The Foreign Exchange Risk: The foreign exchange rate is fixed at the time of the opening of the letters of credit. Therefore, neither the banks nor their borrowers will bear the exchange risk. The absence of any exchange risk will make the borrowings under this project very attractive.

No Impact On Inflation: The private sector enterprises have learned to auto-finance their working capital needs due to the absence of bank credit. When the internal financing mechanism is replaced by a credit mechanism, the overall impact is less inflationary and enterprises do not have to increase their margins to cover the self-financing cost.

BDZ: The project will fund technical assistance for the Central Bank. This should help strengthen the Central Bank's functioning in certain key areas.

The Financial Sector: The overall financial sector will benefit from the reform program which is designed to make the financial institutions more dynamic by inducing banks not only to mobilize more resources but also to increase their level of lending.

EXHIBIT 2.1

SOURCES OF GROWTH IN THE MONETARY BASE

(millions of current zaires)

| | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|
| Monetary Base Sources | 15,660 | 19,999 | 32,111 | 64,490 |
| Monetary Financing of Deficit | 13,657 | 14,957 | 25,043 | 50,766 |
| Bank of Zaire | 13,404 | 14,680 | 20,854 | 28,477 |
| Comm. Banks (T. bills in RR) | 253 | 277 | 4,189 | 4,929 |
| Counterpart Funds - SALs | 0 | 0 | 0 | 17,360 |
| Commercial Bank Borrowing | 1,148 | 2,182 | 3,730 | 15,225 |
| Discounting | 1,148 | 2,182 | 1,216 | 5,081 |
| Money Market | 0 | 0 | 2,514 | 7,858 |
| Others | 0 | 0 | 0 | 2,286 |
| External Account Contributions | 855 | 2,860 | 3,338 | (1,501) |

Source: Bank of Zaire data provided to the World Bank and USAID.

EXHIBIT 2.2

COMMERCIAL BANK SECTOR BALANCE SHEET

(millions of zaires)

| | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|
| TOTAL ASSETS | 9,416 | 14,199 | 18,172 | 30,195 | 68,866 |
| Foreign Assets | 3,298 | 3,019 | 4,323 | 7,422 | 16,501 |
| Domestic Assets | 6,118 | 11,180 | 13,849 | 22,773 | 52,365 |
| Reserves | 3,110 | 6,456 | 7,048 | 12,485 | 26,915 |
| Currency | 260 | 659 | 885 | 1,418 | 2,215 |
| Deposits in BOZ | 2,850 | 5,797 | 6,163 | 11,067 | 24,700 |
| Domestic Credit | 3,008 | 4,724 | 6,801 | 10,288 | 25,450 |
| Private Sector | 2,832 | 4,471 | 6,515 | 9,648 | 22,932 |
| GOZ | 176 | 253 | 286 | 640 | 2,518 |
| TOTAL LIABILITIES | 9,417 | 14,200 | 18,172 | 30,195 | 68,867 |
| Foreign Liabilities | 744 | 511 | 1,002 | 3,093 | 6,355 |
| Domestic Liabilities | 8,673 | 13,689 | 17,170 | 27,102 | 62,512 |
| Borrowing | 573 | 1,148 | 2,182 | 3,730 | 15,225 |
| Discounting | 573 | 1,148 | 2,182 | — | 5,081 |
| Money Market | 0 | 0 | 0 | — | 7,858 |
| Others | 0 | 0 | 0 | — | 2,286 |
| Deposits | 7,213 | 9,483 | 11,576 | 19,237 | 40,281 |
| Private Deposits | 7,121 | 9,459 | 11,483 | 19,069 | 38,975 |
| Demand Deposits | 6,236 | 8,218 | 9,927 | 16,515 | 32,123 |
| Time Deposits | 676 | 995 | 1,047 | 1,855 | 5,042 |
| FX Deposits | 209 | 246 | 509 | 699 | 1,810 |
| GOZ Deposits | 92 | 24 | 93 | 168 | 1,306 |
| Import Prepayment | 248 | 184 | 1,288 | 1,813 | 3,626 |
| Capital Accounts | 778 | 1,406 | 2,185 | 4,729 | 5,427 |
| Other Items Net | (139) | 1,468 | (61) | (2,407) | (2,047) |

# EXHIBIT 2.3

## MONETARY SURVEY

(billions of zaires)

| | 1983 | 1984 | 1985 | 1986 | 1987 | 1988:I |
|---|---|---|---|---|---|---|
| Net Foreign Assets (broad) | (13.5) | (16.7) | (38.5) | (54.5) | (96.7) | (109.3) |
| Net Foreign Assets (narrow) | (10.5) | (13.9) | (36.2) | (48.6) | (86.6) | (99.7) |
| Foreign Assets | 11.9 | 16.4 | 13.2 | 27.1 | 57.2 | 70.1 |
| Foreign Liabilities | (22.4) | (30.3) | (49.4) | (75.7) | (143.8) | (169.8) |
| (Provision for Arrears) | (5.6) | (5.0) | (4.0) | (3.4) | (5.9) | (6.5) |
| Other Net Foreign Assets | (3.0) | (2.8) | (2.4) | (5.8) | (10.2) | (9.6) |
| Net For'n. Curr. Deposits | (0.3) | (0.4) | (0.8) | (0.9) | (2.2) | 0.0 |
| Provision for Imports | (2.7) | (2.4) | (1.6) | (4.9) | (7.9) | 0.0 |
| Net Domestic assets | 14.1 | 19.3 | 24.5 | 39.1 | 62.3 | 58.2 |
| Net Claims on Government | 10.3 | 13.4 | 14.8 | 24.9 | 33.3 | 27.8 |
| Credit to Enterpr. & Hsehlds | 2.9 | 4.6 | 7.0 | 11.4 | 25.1 | 27.8 |
| Other Net Domestic Assets | 1.0 | 1.3 | 2.7 | 2.8 | 3.9 | 2.6 |
| OVERALL NET ASSETS | 0.7 | 2.7 | (14.0) | (15.3) | (34.4) | (51.2) |
| OVERALL NET LIABILITIES | 0.7 | 2.7 | (14.0) | (15.3) | (34.4) | (51.2) |
| Money Supply (M2) | 13.7 | 18.4 | 23.9 | 38.0 | 74.7 | 82.5 |
| Money (M1) | 13.0 | 17.4 | 22.9 | 36.1 | 69.7 | 76.8 |
| Currency in Circulation | 6.1 | 8.8 | 12.3 | 19.0 | 36.4 | 43.1 |
| Demand Deps. (Comm. Banks) | 6.2 | 8.2 | 9.9 | 16.5 | 32.1 | 33.7 |
| Demand Deps. (BOZ & CCP) | 0.7 | 0.4 | 0.7 | 0.6 | 1.2 | 0.0 |
| Quasi-Money | 0.7 | 1.0 | 1.0 | 1.9 | 5.0 | 5.7 |
| Time Deposits (Comm. Banks) | 0.7 | 1.0 | 1.0 | 1.9 | 5.0 | 0.0 |
| Time Deposits (BOZ) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Items Net | (13.0) | (15.8) | (37.9) | (53.3) | (109.1) | (133.7) |
| Gains & Losses | (21.2) | (27.2) | (43.2) | (60.8) | (125.1) | (152.9) |
| Counterpart | 2.4 | 3.4 | 5.3 | 7.5 | 16.0 | 19.2 |
| Discrepancies | 5.8 | 8.0 | 0.0 | (0.0) | 0.0 | 0.0 |

## EXHIBIT 2.4

## OFFICIAL DEVALUATIONS OF THE ZAIRE

| | Devaluation | New Rate | Notes |
|---|---|---|---|
| 1967......... | 67 percent | $ 2.00 | Officially in terms of gold |
| 1968......... | | | |
| 1969......... | | | |
| 1970......... | 0 percent | $ 2.00 | Officially in terms of the dollar |
| 1971......... | | | |
| 1972......... | | | |
| 1973......... | | | |
| 1974......... | | | |
| 1975......... | | | |
| 1976......... | 42 percent | SDR 1.00 | Officially in terms of the SDR |
| 1977......... | | | |
| 1978......... | 11 percent | SDR 0.90 | |
| 1979......... | 44 percent | SDR 0.50 | In two steps at the end of 1978 |
| | 25 percent | SDR 0.375 | |
| 1980......... | 30 percent | SDR 0.2625 | |
| 1981......... | | | |
| | 40 percent | SDR 0.1575 | |
| 1982......... | | | |
| 1983......... | | | |
| | 78 percent | SDR 0.03542 | Floating thereafter |

EXHIBIT 2.5

BALANCE OF PAYMENTS

(Millions of SDRs)

| | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|
| Sources of FX: | | | | | | |
| -- | | | | | | |
| Exports (fob) | 1,317 | 1,577 | 1,871 | 1,825 | 1,572 | 1,341 |
| Services | 76 | 108 | 138 | 151 | 161 | 157 |
| Official Grants | 170 | 162 | 170 | 196 | 157 | 165 |
| Official Loans | 192 | 136 | 132 | 155 | 230 | 320 |
| Priv Loans & | | | | | | |
| Err/Omiss | (116) | (15) | 83 | 111 | 63 | 159 |
| IMF | | | | | | |
| SAF | 0 | 0 | 0 | 0 | 0 | 58 |
| Stand-By | 107 | 115 | 158 | 169 | 81 | 70 |
| Debt relief | 136 | 909 | 466 | 411 | 462 | 567 |
| TOTAL SOURCES | 1,882 | 2,992 | 3,018 | 3,018 | 2,726 | 2,837 |
| TOTAL USES | 2,227 | 2,992 | 3,018 | 3,018 | 2,726 | 2,836 |
| (New Arrears) | 345 | 0 | 0 | 0 | 0 | 0 |
| Uses of FX: | | | | | | |
| -- | | | | | | |
| Imports (cif) | 1,022 | 1,351 | 1,365 | 1,392 | 1,302 | 1,255 |
| Services | 558 | 513 | 627 | 557 | 486 | 545 |
| Debt repayments | 334 | 320 | 420 | 446 | 410 | 399 |
| Interest | 285 | 272 | 367 | 328 | 333 | 331 |
| IMF: Repayments | 22 | 10 | 54 | 104 | 94 | 125 |
| Interest | 24 | 41 | 48 | 56 | 55 | 47 |
| Private outflows | 14 | (3) | 89 | 54 | 53 | 52 |
| Arrears paid | 0 | 480 | 74 | 51 | 24 | 8 |
| Reserves | (32) | 8 | (26) | 30 | (31) | 74 |

Sources: 1985-87: IMF, Aide Mémoire, Table 4 (French, 2/22/88).
1983-84: IMF, EBS/87/86, Table 4 (4/22/87).
1982: IMF, EBS/83/257, Table 3 (11/30/83).

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EXHIBIT 2.6

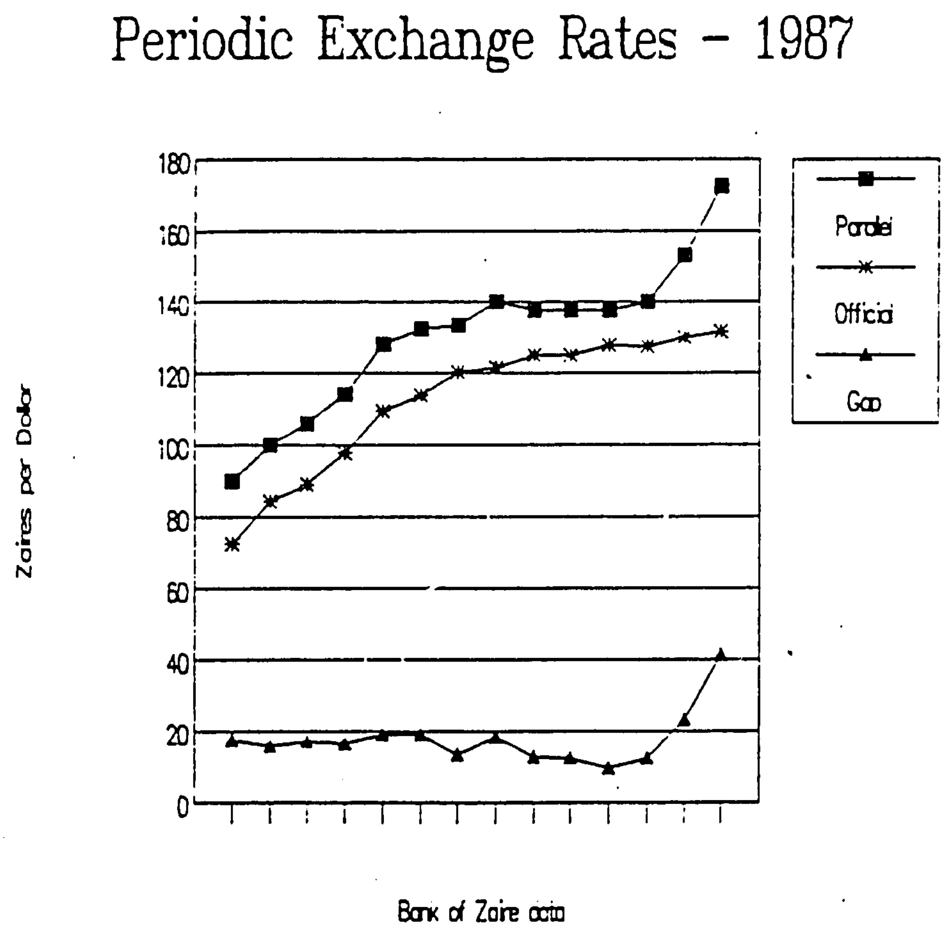
Periodic Exchange Rates - 1987
180
160
140
120
100
80
60
40
20
0
Zaires per Dollar
Parallel
Official
Gap
Bank of Zaire data

EXHIBIT 2.6

ELEMENTS OF CONTROLLED FUEL PRICES

| January 14, 1988 | GASOLINE West | GASOLINE East | DIESEL West | DIESEL East |
|---|---|---|---|---|
| | (zaires per ton) | | | |
| TOTAL : 55.700 m3 /T.M./ mo. | 9200 m3 | 300 m3 | 32500 m3 | 2800 m3 |
| 1 Cost at the Border (PMF) | 19,937.00 | 45,901.00 | 20,984.00 | 45,901.00 |
| 2 Transport & storage cost SOZIR | 1,068.00 | | 1,068.00 | |
| 3 Bank charges (5.2% PMF) | 1,036.72 | 2,386.85 | 1,091.17 | 2,386.85 |
| 4 Loss in transport (0.3% PMF) | 59.81 | 137.70 | 62.95 | 137.70 |
| 5 Import tariff | 50.00 | 50.00 | 20.00 | 20.00 |
| 6 Consumption tax | 600.00 | 600.00 | 130.00 | 130.00 |
| 7 Supply | 12.00 | 12.00 | 12.00 | 12.00 |
| 8 Tax | 100.00 | 100.00 | 100.00 | 100.00 |
| 9 TOTAL Price ex-Customs (PMGD) | 22,863.54 | 49,187.56 | 23,468.12 | 48,687.56 |
| 10 Stabilization Account | 4,500.00 | 4,500.00 | 4,500.00 | 4,500.00 |
| 11 Losses MEP (1% PMGD for gas, 0.5% for diesel) | 228.64 | 491.88 | 117.34 | 243.44 |
| 12 Operating costs SEP | 3,565.00 | 1,339.00 | 3,941.00 | 2,140.00 |
| 13 Operating costs, fuel distrbtrs. | 5,245.00 | 1,795.00 | 1,329.00 | 1,616.00 |
| 14 Operating costs, SOZIR | 1,021.00 | 0.00 | 1,021.00 | 0.00 |
| 15 Margin (10% PMGD) | 2,286.35 | 4,918.76 | 2,346.81 | 4,868.76 |
| 16 TOTAL COST OF DISTRIBUTION | 16,845.99 | 13,044.63 | 13,255.15 | 13,368.19 |
| 17 Roads tax | 7,793.77 | 0.00 | 7,793.77 | 0.00 |
| 18 River tax | 0.00 | 0.00 | 259.23 | 0.00 |
| 19 Farm-to-market roads tax | 500.00 | 0.00 | 1,000.00 | 0.00 |
| 20 Special Treasury Fund no. 1 | 3,104.99 | 0.00 | 0.00 | 0.00 |
| 21 Special Treasury Fund no. 2 | 8,349.48 | (7,123.56) | 5,829.35 | (4,275.55) |
| 22 TOTAL PARAFISCAL TAXES | 19,748.24 | (7,123.56) | 14,882.35 | (4,275.55) |
| 23 Real Reference Price | 59,457.76 | 55,108.63 | 51,606.00 | 57,780.20 |
| 24 Reference Price applied | 59,000.00 | 55,000.00 | 52,000.00 | 58,000.00 |

Source: GOZ Ministry of National Economy and Industry, Departmental Decree No. DENI/CAB/06/001/88 of January 13, 1988.

EXHIBIT 2.7

FINANCING THE GOZ's BUDGET DEFICIT

(millions of zaires)

| | 1984 | 1985 | 1986 | 1987 | 1988:I |
|---|---|---|---|---|---|
| Budgetary Revenues | 27,289 | 43,342 | 50,931 | 87,394 | 29,449 |
| Budgetary Expenditures | 30,901 | 44,889 | 61,585 | 113,638 | 30,842 |
| Budgetary Surplus | (3,612) | (1,547) | (10,654) | (26,244) | (1,393) |
| Budgetary Financing | 3,610 | 1,550 | 10,655 | 26,244 | 1,393 |
| Banking System | 3,041 | 1,300 | 10,087 | 25,723 | (941) |
| BOZ | 2,994 | 1,276 | 6,174 | 7,623 | (2,941) |
| Commercial Banks | 47 | 24 | 3,913 | 740 | .. |
| Counterpart Funds - PBLs | 0 | 0 | 0 | 17,360 | 2,000 |
| Treasury Securities | 569 | 250 | 568 | 521 | 2,334 |
| Treasury Bills | 569 | 250 | 90 | 595 | 2,334 |
| Lottery Securities | 0 | 0 | 478 | (74) | .. |

ANNEX 3

<u>ECONOMIC AND FINANCIAL ANALYSIS</u>

- PRIVATE SECTOR SUPPORT PROGRAM -

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3.6 Notes

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3.9 Financing the GOZ's Budget Deficit
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## 3.1 Summary

Before 1974, the GOZ's economic policy emphasized heavy public-sector investments, nationalization, and high tariff protection. Since the drop in copper prices in 1974 revealed the weaknesses of those policies, the GOZ has adopted a wide range of reforms which have gradually put in place a liberal private-sector oriented economic environment. The key reforms have been:

- Retrocession of Zairianized and nationalized enterprises to private owners, starting in 1976.
- Virtual elimination of agricultural marketing parastatals in 1978.
- Liberalization of interest rates and agricultural and industrial prices in 1981-83 (agricultural interest rates in 1987).
- Liberalization of the exchange rate and import/export transactions in 1983.
- A program of progressive reduction of effective rates of tariff protection starting in 1986.

This program of liberalization is continuing in 1987-88, notably with increased emphasis on privatization of parastatals, reform of parastatal management, and increased private competition in markets which have been parastatal monopolies.

Available figures on GDP indicates that liberalization has arrested the decline in total production between 1974 and 1982 and encouraged moderate growth since 1983. At the same time, however, economic performance has been severely handicapped by the loss of foreign exchange revenues due to further deterioration in the terms of trade since 1974, and to the burden of servicing external debt, contracted almost entirely in or before 1974.

The fiscal impact of the balance of payments crisis has been severe. The GOZ has been successful in dealing with the budgetary crisis mainly in years when balance of payments problems have been relatively manageable, as in 1984 and 1985. Overall, however, fiscal performance has not been satisfactory. While civil service salaries have been reduced to levels that severely compromise the quality of public administration and public services have been drastically cut back, unwise and even unaccounted for public expenditures continue. Tax collection is weak.

As a result of continued high fiscal deficits, the growth rate of the money supply has followed a generally rising trend since as far back as 1971, leading to accelerating inflation and depreciation of the currency, which have mitigated the favorable effect of liberalization on the business climate. Efforts to clamp down on monetary expansion, in the absence of adequate budgetary control, have mainly succeeded in repressing the formal financial system, reducing the mobilization of savings and the availability of credit to the private sector.

The Private Sector Support Program (PSSP) responds to the priority problems of the private business sector as identified by consultants and by the private sector itself: lack of foreign-exchange and lack of liberalized economy where price incentives will, in the medium term, result in efficient import substitution and growth of exports. Continuation of a market-based exchange rate, liberal import and export policies, and progress on tariff-rate reform are therefore critical assumptions underlying the project. Also, improved budgetary control is needed to make structural reforms in the financial sector feasible and to enhance their impact on the private sector. Thus, improved fiscal performance is a second critical assumption.

Within this framework, the PSSP will support medium and smaller scale (MSEs) enterprises directly through financing imports of working materials and investment goods and through financing local costs. This assistance to MSEs will help (1) reverse the decline in industrial production and (2) re-establish demand and supply linkages between urban and rural areas.

With regard to financial sector adjustment, the PSSP will help restructure the zairian commerical banking sector and enable it to support productive investment by medium and smaller-scale enterprises (MSEs). The key elements of the adjustment program are increases in official interest rates in real terms, institutional development of the money market, strengthened supervision of commercial banking, restructuring of public sector financial institutions, and reform in monetary policy to increase the incentives for mobilization of domestic financial resources by formal financial institutions. With reforms, the financial sector will increase domestic resource mobilization and allocate financial resources more efficiently. The PSSP will support this sectoral restructuring effort by financing studies and monitoring, as well as with conditionality on the release of import financing.

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## 3.2 Background

The standard account of the evolution of economic conditions in Zaire divides the period of independence into periods bounded roughly by the years 1967, 1974, 1978, and 1983.1/ (Notes follow the text.) The period before 1967 actually begins with the civil rebellion of January, 1959 in Leopoldville (Kinshasa). This shock, even before Independence in June, 1960, initiated the destruction and flight of expatriate skills and capital upon which colonial development of the Belgian Congo (Zaire) had been so overwhelmingly based. The year 1958 is still the peak year of production and exports for many 'traditional' industries in Zaire.

Unfortunately, Independence did not end civil strife. Between 1960 and 1965, the GOZ gradually brought internal rebellions under control with the help of external military assistance. The problem of internal political divisions was solved, if only superficially at first, by the army's coup d'etat under General Mobutu in November, 1965. In time, President Mobutu proved capable of forging a stable regime which largely submerged divisive regional factors.

### (1) 1967-74

The beginning of the second period is marked by the return to relative calm and the major monetary reform of June, 1967, in which a new currency, the zaire, was created with a value of $2.00. The period through 1974 is characterized economically by relatively favorable terms of trade, rapid growth, and development of ambitious public investment projects. Politically, the period is characterized by efforts to replace expatriate control over resources by Zairian control.

On the economic side, the external terms of trade reached an all-time high in 1969.2/ The peak in nominal copper prices reached in 1974 contributed to the record imports registered in that year. Thanks to the availability of export revenues, investment was as high as 23.5 percent of income during the period 1968-73. This fuelled relatively rapid growth of domestic economic activity: GDP is estimated to have grown at about 7 percent per year.

Even before the 1967 stabilization program, an oil refinery was erected on the Atlantic coast at Muanda (operated by a parastatal, SOZIR). An important aspect of economic activity after 1967 was the program of additional government investments in major industrial projects. Emblematic of this public investment program are the steel mill east of Kinshasa at Maluku (operated by another parastatal, SOSIDER), and the Inga hydroelectric power complex, including two generating installations on the Zaire River 200 km southwest of Kinshasa at Inga and a line carrying power from that site 1,800 km to the copper belt in Shaba Region, southeastern Zaire (all operated by the national electricity parastatal, SNEL).

The post-1967 projects share several characteristics.3/ They are realizations of President Mobutu's personal political commitments, for which the government contributed the bulk of the capital. In fact, several major projects were executed under the capital budget of the Presidency rather than by an administrative department of the government. Much of the capital was borrowed from overseas with the government's guarantee. Furthermore, the projects were all heavily dependent on imported inputs. No Zairian crude oil was available for the refinery (and crude discovered since is unsuitable), Zairian iron ore reserves remain to be developed and would be inordinately expensive, and even the hydroelectric complex requires very substantial expenditures on expatriate management.

None of these projects has proven to be economical (although a more limited development of hydroelectric power for the region around Kinshasa would have been justified). The steel mill has virtually ceased to operate. The refinery and overall Inga-Shaba complex operate far below capacity, do not recover costs, and only replace less expensive alternate sources of supply. The total cost of the refinery, steel, and power projects mentioned was about $2 billion expressed in the purchasing power of the early 1970s, which is equivalent in 1985 U.S. purchasing power to about $4 billion.

Private investment during this period was also strongly conditioned by government policy, as implemented through tariff protection, import quotas, and fiscal advantages. These were offered on an ad hoc basis virtually upon request.4/ New foreign investments in, e.g., vehicle assembly and tire manufacture, were elicited by these methods during this period. These industries also were dependent on imported inputs (kits of vehicles to be assembled, synthetic rubber).

In contrast, the rural economy was not targeted for major investments. National agricultural output per capita probably fell, and imports of food grew.5/

Nonetheless, the 1967-74 period was perceived as a boom. Zairians were optimistic and their aspirations to take control of the economy and its assets were naturally high. This had been one of the goals of Independence whose realization had been delayed by the disruptions of 1960-65. The principal objects of this movement were the great land concessions of the Leopoldian and Belgian eras and the mining enterprises built on them. In fact, some major concessions had been annulled in 1964. The most important action, however, was the nationalization of the major copper-mining company in 1967 and the creation of a parastatal, now called Gecamines, to manage it. The GOZ paid (generous) compensation for all of these rights and properties.

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At a different level, the agribusiness, plantation, and rural commercial sectors were still largely owned and managed by businessmen of European, Middle Eastern, or South Asian origin. In late 1973, President Mobutu decided that all such businesses should be taken over by ethnic Zairians ("zairianization"). This was largely accomplished in the following year by prominent Zairians acting in their private capacities.

The effects of these takeovers were, on the positive side, short-term capital gains for Zairians and a somewhat accelerated process of introducing Zairians into management, and, on the negative side, rapid decapitalization and disorganization of agribusiness and the rural economy, and a lasting blow to Zaire's investment climate for private enterprise.

(2) 1974-78

The year 1974 is recognized as the year when Zaire's growth bubble burst and the economic crisis began, mainly because of the major drop in the price of copper that occurred in mid-year, following the world-wide petroleum crisis. In fact, however, signs of impending problems had been gathering for several years. High copper prices up to 1974 had only temporarily masked these problems.

--- Using a base wider than just copper prices, Zaire's overall terms of trade had already peaked in 1969. (See Exhibit 3.14: Terms of Trade.) The drop in the terms of trade between 1974 and 1975 was certainly important, but overall not the sole cause of the difference between the terms of trade of the late 1960s and those the late 1970s.

--- The decline in certain traditional agricultural exports was already evident by 1975. Exports of palm products fell from 241,000 tons in 1968 to 113,000 in 1975; rubber exports fell from 40,000 tons to 24,000 tons over the same period.

-- Zaire's per capita imports were already showing some slippage between 1970 and 1973. (See Exhibit 3.15: Real Per Capita Imports.) After imports peaked in 1974, the slippage resumed for two years, only to collapse in 1977 and 1978.

--- The growth in Zaire's money supply began accelerating in 1970; after a pause in 1974 and 1975, that acceleration resumed in 1976-78. (See Exhibit 3.16: Growth in the Money Supply.)

--- The zaire currency had already become overvalued in 1972-73. (See Exhibit 3.17: Overvaluation of the Zaire.)

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--- Real per capita expenditures by the GOZ on goods and services also show a generally declining trend starting in 1970. (See Exhibit 3.18: GOZ Expenditures on Goods and Services.)

--- The main part of Zaire's debt, in terms of constant dollars, was already accumulated in 1974. (See Exhibit 3.19: Zaire's External Public Debt.) The burden in terms of the quantity of exports required to pay off that debt was, however, greatly increased by the drop in export prices after 1974. (See Exhibit 3.20: Exports Required to Pay Off the Debt.)

Therefore, the zairianization and copper-price shocks of 1974 only took an already increasingly difficult situation and turned it into a full crisis. In 1975, the GOZ went to the IMF for help in meeting external payments. The first of what turned out to be a series of Stand-By Agreements with the IMF went into effect in March, 1976. (See Exhibit 3.7: Zaire's Stand-By Agreements with the IMF.) It was accompanied by a loan from the Compensatory Finance Facility, recognizing the fact that falling terms of trade were an important source of Zaire's payments problem.

For the first Stand-By Agreement, the GOZ devalued the official rate for the zaire from $2.00 to $1.16. (See Exhibit 3.8: Official Devaluations of the Zaire.) In 1975-76, the GOZ also addressed the problems created by zairianization, first through nationalization in 1975 of enterprises which were clearly mismanaged or abandoned by their Zairian acquirers, and second through gradual retrocession starting in 1976 of many zairianized or nationalized enterprises to their original private owners.

However, these steps were far from sufficient to address the overall economic crisis. The seemingly large devaluation was in fact only a modest step toward equilibrium, as the official rate still averaged nearly twice the parallel rate in 1976. (See Exhibit 3.17: Overvaluation of the Zaire.) The payments crisis continued, but adequate recognition of the seriousness of the situation seemed to escape the GOZ, as it refused to devalue the exchange rate in 1977 and failed to fulfill the terms of the second Stand-By Agreement, which was effectively annulled in November, 1977.

(3) <u>1978-82</u>

The year 1978 proved to be something of a turning point in the GOZ's approach to the crisis, although the change in policy was gradual and economic deterioration continued for years thereafter. It was a difficult year, as a bad drought in the region of Bas Zaire and two invasions of Shaba in 1977 and 1978 sapped national economic production.

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But 1978 also saw the beginning of a series of more active measures on the part of the GOZ. After the cancellation of the IMF's Stand-By program in November, 1977, President Mobutu announced the Mobutu Plan for economic rehabilitation. This began a series of plans and programs that have developed with time into more considered approaches to governmental development expenditure. The GOZ devalued the currency's official rate twice in late 1978 for a total of 44 percent.

Also, a wide range of agricultural marketing parastatals were abolished or reorganized in 1978. Prior to May, 1978, the GOZ operated eleven principal agricultural commodity offices: for cotton (ONAFITEX), livestock products (ONDE), cereals (ONACER), coffee (ONC), fish (ONP), sugar (ONDS), cocoa (ONDC), ivory (ONI), wood products (ONB), rubber (ONCN), and oil products (ONO).

In May, 1978, the GOZ initiated a complete reorganization of these agencies. Seven were dissolved completely (including ONACER, ONAFITEX, ONO, and ONB), while the others' roles in the market were reduced. ONPV replaced ONACER, but was itself abolished and not replaced in early 1981. CSCo replaced ONAFITEX, but with a mandate primarily to support cotton production through research and extension. OZACAF replaced ONC, primarily to manage Zaire's export quota determined by the International Coffee Organization. By 1982, only CSCo, OZACAF, and ONDE were still functioning.6/

As a result, the dialogue with the IMF resumed and a new 18-month Stand-By Agreement was reached in late 1979. When the GOZ succeeded in meeting its terms, agreement on a major 3-year Extended Fund Facility (EFF) was reached (June, 1981).

A key step initiating the EFF was the June 1, 1981 measure lifting price controls on a wide range of goods and services at the ex-factory, wholesale, and retail levels. Liberalization was not total, however, as limited, ex-post price control still applied to goods and services considered "strategic", including palm oil, wheat flour, sugar, petroleum and pharmaceutical products, construction materials other than wood, water, electricity, and internal public transport. Under ex-post price control, price increases could be put into effect by producers without prior authorization and automatically became valid 30 days after notification of the GOZ, unless a specific negative decision was taken.7/ The GOZ expanded liberalization further in May, 1982, lifting the remaining controls on pricing of natural rubber, palm oil, and sugar.8/

Nonetheless, there were still serious problems with economic management. The GOZ's expenditures were not under control, nor were foreign-exchange assets of the Bank of Zaire. The zaire was still badly overvalued. Furthermore, 1981 and 1982 were again difficult years from the point of view of the terms of trade. As a result, the GOZ was unable to meet its fiscal engagements, and the Extended Fund Facility was canceled in June, 1982. A Compensatory Financing Facility granted in March of that year was suspended at the same time.

## 3.3 The Structural Adjustment Period

### (1) The Stabilization Program of 1983

As regards policy reforms, the period 1983 and afterward is in some ways a continuation of the previous period, particularly in maintaining the liberal reforms in marketing and pricing introduced from 1978 to 1982. The legal basis for existing commodity price liberalization was strengthened on September 12, 1983 by issuance of an "ordonnance-loi". Interest rate liberalization, begun in 1981, was extended to all bank rates except for non-coffee agriculture, while several official interest rates at the Bank of Zaire were increased.

The period since 1983 is marked, however, by the first signs of a genuine turnaround in economic management and economic activity. In retrospect, 1982 appears to have been the trough of the crisis, as total (but not per capita) GDP appears to have risen each year from 1983 through 1987. (See Exhibit 3.1: Growth in Real GDP.)

The GOZ's main achievement in 1983-85 was the liberalization of the foreign trade regime and the reduction of inflation. Liberalization of foreign trade was accomplished through a series of measures.

--- The exchange rate was devalued between September, 1983 and February, 1984 to virtual parity with the parallel rate (a five-fold increase in the price of the dollar). Commercial bank exchange rates floated freely thereafter until late 1986. The Bank of Zaire adjusted its rate for official transactions weekly in order to stay within 10 percent of the free market rate.

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- --- Ex ante licensing of imports was eliminated (except for a small number of restricted commodities).

- --- The requirement that the commercial banks surrender 30 percent of foreign exchange export earnings was abolished.

- --- Trade in artisanal diamonds and gold was freed in early 1983. Until liberalization of the exchange rate, the exporting agencies were paid at a "mineral recovery" rate near the parallel rate.

- --- Important steps were also take to ensure full recovery of Gecamines' export receipts and adequate financing of Gecamines' import requirements.

Thanks in part to relatively high export earnings in 1984 and 1985, performance under this new policy regime was good. Fiscal targets were largely met, and the rates of price inflation and of depreciation of the currency were reduced. Enough foreign exchange was available to permit the new foreign exchange market to function adequately.

The year 1985, however, was marked by adverse movements in the terms of trade, and depreciation of the zaire accelerated somewhat. Nonetheless, the interbank foreign-exchange system continued to operate, and the spread between the bank exchange rate and parallel rates remained tolerable at less than 10 percent, with much lower volumes being traded in the parallel market than before the floating of the zaire. However, trading between commercial banks in the market was slow. The interbank foreign exchange market system clearly came under strain, but it still had the commitment of the GOZ and of the private sector.

The reduction in the GOZ's deficit in 1984-85 was a very creditable fiscal achievement, especially given the care taken to give the GOZ's number one taxpayer, Gecamines, adequate resources for its rehabilitation investment program. The GOZ undertook a long list of measures to improve revenue collection under existing laws and raised taxes in certain cases. Nonetheless, it was also necessary to cut expenditures on goods and services substantially (see Exhibit 3.18: GOZ Expenditures on Goods and Services).

## (2) The Structural Adjustment Programs: 1986 to Date

While the monetary and fiscal reforms had considerable success and economic growth improved, the Zairian economy was still hampered by the increasingly tight foreign-exchange situation after 1984 and by the weakness of the country's institutional and physical infrastructure. In 1985, the World Bank determined to initiate a Structural Adjustment lending program in Zaire, the elements of which to date have been the Industrial Sector Adjustment Credit (ISAC) of 1986, the Structural Adjustment Loan (SAL I) in 1987, the Financial Sector Adjustment Credit (FSAC) still under study for 1988, and a SAL II expected in 1989. In addition, the IMF began a three-year program of loans under its Structural Adjustment Facility (SAF) in 1987, which is to be coordinated with the World Bank's SALs.

### 1. The Industrial Sector Adjustment Credit

The ISAC's measures focus on the incentive environment for industrial investment with the goals of better use of domestic raw materials, establishment of export-oriented industries, and establishment of efficient import-substitution industries. The main aspects of the strategy are tariff reform, further pricing liberalization, export promotion, and improvement of credit markets and institutions.

Industry in the narrow sense of processing and manufacturing (excluding thus agriculture, mining, services, and commerce) underperformed relative to GDP between 1972 and 1982, recovering somewhat since 1984. (See Exhibit 3.2: Structure of GDP, and Exhibit 3.22: Industrial Output in Zaire.)

One of the main reasons for this poor performance is the lack of inputs. Relatively little was done in the GOZ's development strategy between 1967 and 1978 to encourage production of Zairian industrial crops. Approximately 70 percent of Zairian industry is based on Zairian agricultural inputs (palm products for soap and margarine, cotton for textiles, coffee for drying, sugar for refining, and so forth). Many of the outputs from this sector are basic consumer goods for local markets.

Instead of rehabilitating and maintaining infrastructure, the agribusiness sector was thrown into turmoil by zairianization in 1974. Domestic production of industrial crops was also hampered by price controls and parastatal marketing over much of the period until 1982.

The GOZ's development strategy concentrated on import substitution through tariff protection and fiscal incentives, which were to be had virtually for the asking in the early 1970s. As the 1970s progressed, overvaluation of the zaire naturally furnished exaggerated protection to all import-competing industries. After 1975, the GOZ's administrative decisions under import-licensing played an important role in determining the structure of industrial investment and capacity utilization.

This protected-industry strategy created an industrial structure with an accentuated demand for imported inputs, which became much more scarce as terms of trade declined throughout the 1970s and early 1980s. The steel mill and the petroleum refinery, which are almost totally dependent on imported inputs, have therefore been among of the worst industrial performers.

Furthermore, until 1981 industrial producer prices were subject to ex-post control by the GOZ, under the standard that set market prices at production costs (as reviewed and approved by the GOZ) plus 20 percent. In a period of rapid inflation, the GOZ's cost standards failed to provide adequately for revaluation of fixed investment. Thus, industry was unable to cover the costs of maintenance of capital at replacement prices.

The reforms since 1978, and especially those of 1983, removed or mitigated many of the features of the old strategy. However, an administrative bias against exports remained, as testified to by the total of 17 different steps required by the GOZ for official approval to export, and price control mechanisms had not been definitively dismantled.

Furthermore, the reformed tariff structure put in place at the time of the September, 1983 devaluation created a regime of high but very variable effective rates of protection for industry.9/ To reduce the impact of the devaluation on the cost of living, import duties on many consumption goods (such as corn, fish, groundnuts, palm oil, salt, sugar, and pharmaceuticals) were reduced from 10 percent to 3 percent, duties on intermediate goods and inputs were reduced from 20 to 3 percent, and duties on some utility vehicles from 72-167 percent to 50 percent. To make up for the revenue loss, duties on luxury items were increased: on private vehicles from 130 percent to 200 percent, on electrical appliances from 67 percent to 200 percent, on decoration articles from 50 percent to 100 percent, on luxury foodstuffs from 50 percent to 100 percent, and on other non-priority items from 90 percent to 130 percent.10/ A study in the Ministry of Plan supported by the World Bank covering 26 industries in 1985 found effective rates of protection varying from -20 percent to 1,800 percent, with an average of 300 percent.

The ISAC was designed to reform these aspects of industrial policy: high and variable effective rates of protection, price controls, obstacles to exports, and inefficient business taxes. The basic measures adopted were:

--- A multi-year program to unify all import tariffs at ad valorem rates within a narrow range around 30 percent.

--- Quick elimination of a number of export taxes and fees.

--- A multi-year program to simplify export procedures.

--- Elimination of ex-post industrial price control.

Progress on the first three measures has been satisfactory. By September, 1987, most tariff rates had been brought within the range from 10 to 50 percent, and the number of exemptions had been drastically reduced. Export fees and procedures have been reduced in importance. Ex-post price control procedures, however, have still not been eliminated, although their actual effectiveness appears to be limited.

The impact of these measures will be felt in the medium term as investment decisions are made. However, early responses by the industrial sector included some retrenchment in low value-added assembly industry as a result of reduced tariff protection.

2. The Structural Adjustment Loan of 1987

The first SAL is a multi-sectoral policy reform effort which includes reform in public enterprises, public expenditure programming, fiscal management, the financial sector, the civil service, agriculture, and transportation. It continues previous World Bank's efforts in a number of areas:

--- Improved investment planning through better formulation and coordination of the Public Investment Plan with donors.

--- Tariff reform.

--- Export promotion.

--- Structural reform of parastatals in the transportation sector (particularly ONATRA for river, rail, and port facilities, and SNCZ for rail services).

The SAL adds, however, emphasis on improving public sector management of the tax system, of the civil service, and of parastatals. Many measures therefore have to do with public administration, policies on recruitment, promotion, and remuneration, parastatal management structures and accountability, and privatization.

Furthermore, the SAL is linked to the IMF's commitment in 1987 to a three-year Structural Adjustment Facility (SAF) loan. Thus, the SAL's funding releases depend not solely on the multi-sectoral conditionality described above, but also on the GOZ's formulation of macroeconomic targets with the IMF in a Policy Framework Paper (PFP) and on adequate performance against those targets.

3. <u>The Financial Sector Adjustment Credit</u>

Both SAL I and SAL II have or will contain financial sector reform elements. In order to maintain a constant stream of non-project balance of payments assistance to Zaire, the World Bank developed the FSAC as a separate operation to bridge between disbursements of funds from the two SALs.

The World Bank's experience in Zaire's financial sector dates back fifteen years to the founding of the development bank, SOFIDE, which is currently using funds from its eighth credit from the IDA. The World Bank also launched a Small Enterprise Development credit in 1987. The World Bank staff who designed and supervise these programs are now working on the financial sector development program.

The joint SAL/SAF program contained a financial sector element which initiated discussions in the area of credit policy. Under this program, the requirement for central bank approval of agricultural and medium term loans was eliminated, agricultural interest rates were freed from control, allocation of credit ceilings was streamlined, and the turnover tax on interest earnings was eliminated. Some progress was also made in discussing agricultural credit policy, regulating credit cooperatives, and improving regulation of commercial banks.

The overall objectives of the FSAC are to substitute indirect for direct regulation of the financial sector, to improve the mobilization of resources and to increase the availability of credit. The priority measures taken will be to improve control over the money supply and the working of credit and financial markets. Secondly, measures will be considered to improve the policies followed by the commercial banks and other credit institutions concerning credit allocation, interest rates, and financial intermediation. In addition, several financial institutions urgently need rehabilitation measures. Finally, some reform in financial regulations will be proposed to support the restructuring planned under other measures.

The details of the financial sector program are discussed in Annex 2, The Technical Analysis.

4. Structural Adjustment Loan II

SAL II is planned to continue with further measures on tariff reform, fiscal reform, rationalization of public expenditures, civil service reform, and the restructuring and privatization of parastatals. In addition, SAL II will address problems in agriculture, transportation, small and medium enterprise, PVOs, and the social impact of structural adjustment programs.

(3) The GOZ's Macroeconomic Policy Since 1986

After the successes in macroeconomic stabilization in 1984 and 1985, but before disbursements began under Structural Adjustment, a reaction against the fiscal austerity program developed within the GOZ. This reaction was based on the increasing hardship resulting from falling terms of trade in 1985 and 1986, the weak response from private sector investors to the improved business climate, and the seemingly endless treadmill of annual debt reschedulings with capitalized interest leading to ever more impossible total external debt obligations. At the same time, net donor assistance was essentially static, while net assistance under the IMF's short-term stabilization loans was threatening to turn negative.

The GOZ's reaction manifested itself as the October, 1986 demands to limit debt service payments, to negotiate more favorable debt and aid agreements with donors, and to reject certain liberal economic reforms that were stigmatized by their association with macroeconomic austerity. In this environment, budgetary discipline was relaxed and inflation accelerated rapidly.

Implementation of two important pricing policies also deteriorated. The official exchange rate of the Bank of Zaire had been set at Friday morning auctions since February, 1984. For most of 1985 and 1986, however, so little foreign exchange had been available for trading that the auctions had practically ceased and the Friday morning fixings had become essentially administrative. Nonetheless, the Bank of Zaire did not interfere with rate setting by the commercial banks in their day-to-day transactions, and it realigned its own rate weekly to keep pace with the free market.

Starting in or just before October, 1986, however, the Bank of Zaire refused to continue devaluing at the pace of the free market, and the official exchange rate thus became overvalued. Furthermore, the Bank of Zaire used informal pressure to require commercial banks to remain within one or two percent of the official rate. Thus, a system emerged with three exchange rates: the Bank of Zaire rate, the (nearly equivalent) commercial bank rate, and the parallel market rate. By the end of 1986, the gap between the official and the parallel rates was about 30 percent, compared to less than 10 percent for most of 1984 and 1985. This resulted in increased flight of export earnings from the banking system to the parallel market.

The second controversial pricing policy concerned refined petroleum products, whose retail prices in local currency are controlled according to a formula that includes about fifteen elements, starting with cif import costs and adding distribution costs, margins, and taxes. (See Exhibit 3.12: Elements of Controlled Fuel Prices.) As world fuel prices increased and depreciation of the currency became more rapid in 1986, the need for revision of the cost elements of the formula became much more pressing than in the previous two years, where lower world fuel costs had more or less offset relatively moderate depreciation of the zaire currency.

From 1985 through 1987, however, the GOZ revised the formula only once in about each seven months, instead of quarterly as had been agreed. In late 1986 and early 1987, therefore, local distribution companies in Zaire, most of which are basically private companies, were collecting revenues at the pump based on cif import costs calculated at exchange rates and world fuel prices far below those that the companies were actually paying when opening import letters of credit. The companies were rapidly decapitalizing and building up debts to the banking system, to the point where banks were unwilling to accept further risk exposure and the supply of fuel in Kinshasa was threatened (other areas of the country having long since been cut off from official fuel supplies).

Using as incentives the newly available SAL and SAF funds, along with smaller associated grants from bilateral donors (including USAID AEPRP-funded Structural Adjustment Support Grant), and a longer-term debt rescheduling agreement, the international community convinced the GOZ in 1987 that it was in Zaire's best interest to continue its liberalization and stabilization programs. The GOZ undertook, among other measures, devaluations of the exchange rate and increases in fuel prices throughout 1987. Thus, while the 1986-87 IMF Stand-By funds were never fully disbursed, the ISAC was released (along with AID's grant), the SAL and the SAF were committed, and a new Stand-By was negotiated.

Under continuing pressure from falling foreign exchange availability, however, the same problems reappeared at the end of 1987. The gap between official and parallel exchange rates was again up to 30 percent, budgetary targets were badly missed, and inflation in the first quarter of 1988 was back at about 100 percent annual rate.

## 3.4 Current Macroeconomic Outlook

### (1) Gross Domestic Product

The best information available indicates that Zaire's real output per capita has stabilized since 1983, after a reaching a trough in 1982 (Exhibit 3.1). The main declines since 1960 have been in commercial agriculture, especially exports, and in manufacturing, largely agricultural processing, which have both lost share in GDP (Exhibit 3.2).

In commercial agriculture, for example, production of raw cotton dropped from a peak of 180,000 tons in 1959 to 19,000 tons in 1985-86. Average annual exports of palm oil were 160,000 tons in the late 1950s; total national production was 76,000 tons in 1986, as against 213,000 tons in 1970. Rubber production fell by 40 percent between 1978 and 1986.

The mining sector thus increased its share of output and exports. Subsistence agriculture was probably also stable, given the relatively constant climate, the still relatively abundant availability of land, and the minimal dependence of the subsistence sector on off-farm inputs.

As the main possible losses to commercial agriculture and industry have already occurred, the main further risks to the economy are reductions in mineral export revenues or in net official capital inflows. Loss of mineral export revenues could result from falling world prices, deteriorating production facilities, or disruption of transportation systems through physical deterioration or political/military actions. Since 1983, however, a new fiscal arrangement with the main mining enterprise, Gecamines, has ensured adequate maintenance of production facilities.

Falling net official capital inflows could result from falling new aid flows or from failure to restructure debt obligations when due. Annual debt reschedulings have taken place since 1983, and donor assistance has revived somewhat since 1986, with the debut of Structural Adjustment lending by the World Bank and the IMF.

(2) The Balance of Payments

Since 1986, however, foreign exchange availability has fallen off (Exhibit 3.3). The cause of the increasingly tight foreign-exchange position, compared to 1984 and 1985, appears to be lower export receipts, particularly in crude oil and cobalt (Exhibit 3.5). As for the budgetary deficit, the principal factor in both 1986 and 1987 appears to have been weak tax collection (Exhibit 3.6), although once performance criteria for 1987 were out of reach it appears that the GOZ decided to clear up some additional external arrears in order to improve the starting position for 1988.

Although inflation and the foreign exchange shortage have not prevented growth in GDP, at least according to available figures, they do dominate the public perception of economic performance, with the population focusing on inflation and the business community being preoccupied with foreign exchange availability. Banking sources estimate the unmet demand for import letters of credit at $15 million per month, above the actual volume of between $40 and $60 million. Businesses report to analysts that the primary obstacle to greater production is the lack of foreign exchange for imported inputs. (See Annex 2.2, The Technical Analysis for synthesis of the Coopers & Lybrand reports on MSEs.)

Early projections of export revenues in 1988 foresee a further decline of about SDR 40 million (including services), despite relatively favorable copper prices. Debt service in 1988 (excluding IMF transactions) is estimated at about $850 million, compared to actual cash payments in 1987 of $168 million. Clearly, another major rescheduling will be required. Even then, an estimated $210 million of payments due in 1988 are not reschedulable under current practice. Furthermore, the IMF should collect SDR 221 million in repurchases (repayments) and charges (interest) from Zaire in 1988 (up from SDR 172 million in 1987), compared to probable 1988 disbursements under the SAF of only SDR 87 million. Meanwhile, external assistance (grant and loans) is expected to increase by only SDR 13 million in 1988.

In this context, the GOZ has requested, in addition to a rescheduling on special terms, a three-year debt service moratorium.

(3) The GOZ's Budget

A key feature of the period since mid-1986 has been the increase in the GOZ's budget deficit, which has inflated the money supply and accelerated inflation (Exhibits 3.4 and 3.23). Bank (primarily Bank of Zaire) credit to the GOZ greatly exceeded targets in late 1987, leading to abandonment of the 1987 IMF Stand-By program in February, 1988.

The recommended fiscal program for 1988 includes a number of specific measures to improve collection of taxes due under current law as well as reforms to make budget revenues more elastic. Nonetheless, revenues in the first quarter of 1988 were still not up to programmed levels (see Exhibit 3.6). Meanwhile, recent inflation (100 percent annual rate in the first quarter of 1988) continues to put pressure on the GOZ to increase expenditures, especially for civil service salaries.

(4) Recent Actions by the Bank of Zaire

In a document prepared for discussions with donors, "The Economic and Financial Situation in Zaire: First Quarter, 1988" (April, 1988), the Bank of Zaire has stated its views on what it characterizes as the most important part of the financial sector reform program, the reforms of monetary policy. First, the Bank states the need to adjust the Central Bank's interest rates on loans to the banking sector in order not to undercut the potential for a free, private money market. As a first step, the Bank of Zaire's rates were raised by 10 percentage points on March 17, 1988. The money market rate is now 35 percent, the discount rate 37 percent, and the rate on unsecured advances 39 percent.

In this document, the Bank of Zaire also agrees on the need to reduce the difference between interest rates on Treasury Bonds sold to banks (which now bear 8 to 10 percent interest) and those sold to the public (34 to 45 percent interest) and on the need to review reserve requirements with a view both to controlling aggregate liquidity and inflation and to encourage deposit mobilization. Effective May 2, 1988, the Bank raised the reserve requirement from 47 to 50 percent.

3.5 The PSSP's Policy Program

(1) Problems and Objectives

The financial sector problems to be addressed by the PSSP are the decline in financial intermediation as shown by the decline in the real money supply (Exhibit 3.26: The Real Money Supply), the low level and lack of growth in real deposits in the banking system (see Exhibit 3.24: Real Deposits in Commercial Banks), the decline of bank deposits to less than 50 percent of domestic liquidity (see Exhibit 3.27: Composition of the Money Supply), and the low growth in locally-financed bank credit (see 3.21: Commercial Bank Credit in Real Terms).

In addition, the efficiency of allocation of any additional resources mobilized by financial institutions needs to be ensured through adjustments in the level and structure of real interest rates.

The policy constraints on financial institutions have been described in the previous sections: macroeconomic instability, restrictive stabilization policies including administrative credit ceilings and high unremunerated reserve requirements, excessive dependency on the central bank for liquidity, some residual allocation rules for credit, and informal controls on interest rates.

In addition to these policy constraints, the financial sector must also face structural problems such as the existence of unmonetized parts of the economy (a problem exacerbated in Zaire by the decay of transportation infrastructure and by demonetization of large bank notes in 1979 --- itself a measure to combat inflation), lack of familiarity with checks and banking, the high cost of banking services, and weaknesses in the legal environment that hamper the pledging of collateral and make loan security doubtful.

Finally, the financial sector is also hampered by institutional weaknesses, especially in public sector institutions, some of which are not effectively managed internally or effectively regulated by the authorities.

The PSSP will assist the GOZ in devising financial stabilization policies and financial sector regulatory policies that permit efficient, noninflationary resource mobilization and credit expansion. The PSSP will also assist financial institutions themselves in overcoming sectoral and structural obstacles to expanding their services, especially term credit, and their clientele, especially MSEs. Consistent with its focus on commercial banks and private enterprise, the PSSP will specifically support measures to:

--- Establish an incentive framework for the commercial banking system that will encourage increases in the real value of both resources mobilized and credits allocated by commercial banks to the private sector.

--- Identify structural and institutional constraints to financing private enterprise, which may be reduced by measures or assistance under this or future projects.

Key specific issues include the following.

--- GOZ Budgetary Deficit

This is the single most important issue confronting monetary policy in Zaire today. The GOZ deficit was targeted by the IMF at 6 billion zaires at the end of 1987. When the year end books were closed, the deficit stood at 26 billion zaires. This deficit is entirely financed by the Bank of Zaire, hence fueling the inflationary spiral.

Before progress can be expected in the strengthening of the financial sector, it is imperative that the GOZ deficit not only be brought under control but its financing rely more heavily on public borrowings - issuance of medium to long term Treasury bills or other innovative means of financing the deficit - and less on short term monetary solutions.

--- Credit Ceilings And Reserve Requirements

Provided that the deficit financing issue can be resolved by the Treasury to the satisfaction of the monetary authorities and the IMF, the Bank of Zaire should start removing the mechanical means of controlling money supply such as reserve requirements and credit ceilings and replace them by better policy tools such as control over the increase in money supply itself. But as long as the Bank of Zaire deficit continues to be financed by the Bank of Zaire, the monetary authorities will have no control over the money supply in which case the credit ceilings and reserve requirements will remain the only basic credit expansion and money supply control tools.

--- Treasury Bills

Treasury bonds and bills need to play a major role in the financing of the GOZ deficit and in sponging off the excess liquidity from the public. To reach this objective there is a need for the issuance of the Treasury bonds with medium to long term maturities at competitive rates for subscription by banks and other financial institutions so as to finance the deficit without expanding the money supply.

Currently banks are not permitted to purchase and carry Treasury bills in their portfolios. It has been recommended that the negotiability of these instruments be extended to the commercial banks. The latter could be involved in placing them and hence stimulate the creation of a Treasury bill secondary market.

The Treasury bonds and bills could also be included as part of the banks' required reserves, thereby reducing the cost of funds to the banks since current reserves are not remunerated.

The Treasury bonds and bills could also be offered to institutional investors other than banks in order to widen their distribution.

--- The Institutional Framework

The strengthening of the weak financial institutions such as NBK or CADEZA should be given a definite priority within the reform agenda. Some of these institutions will require internal restructuring, increases in capital base, and technical assistance to help them train the professional staff and install sound managerial systems.

(2) Prior Actions

Prior to signature of the grant agreement, the GOZ must have taken substantial measures manifesting its intention to continue its overall macroeconomic program of structural reform and adjustment. Specifically, the GOZ will have taken the following prior actions:

- Reduction in the gap between the official and parallel exchange rates, particularly through devaluation of the official exchange rates.

- Reduction of the gap between inflation and the Bank of Zaire's interest rates on advances to commercial banks, particularly through increases in nominal interest rates.

- Revisions in taxes and in tax administration to progressively reduce the GOZ's budget deficit

(3) Covenants

. Macroeconomic Covenants

Balance of payments assistance offered by the PSSP is predicated on the continuation of liberalization, stabilization and structural adjustment programs which the GOZ has been following in recent years. The following macroeconomic covenants will be included in the grant agreement:

o Limitations on the GOZ budgetary deficit.

o Maintenance of free interest rates.

o Maintenance of floating exchange rates.

o Maintenance of full cost fuel pricing.

o Maintenance of liberalized pricing policy for agricultural and industrial products.

o Continuation of tariff reform.

AID/GOZ Consultative Process

In addition, a covenant will be included under which the GOZ agrees to meet with AID bi-annually, to monitor compliance with the various conditions and covenants of the Project Agreement, monitor progress of the financial sector, review the recommendations of studies carried out under the project, review the results of project activities and establish conditions precedent which shall apply to subsequent disbursement under the project. In addition, not less than six months after the signing of the Project Agreement, the GOZ will agree with AID on a list of criteria with which to monitor the progress of financial reform as outlined in the Financial Sector Development Policy Statement or as undertaken as reform measures.

These criteria may include but need not be limited to the following:

(a) the real growth of domestic financial resources and private savings held by the banking system;

(b) the reduction in the gap between the Bank of Zaire's lending rates of interest and the inflation rate;

(c) the increase in the real value of credit extended by the banking sector to the private sector; and

(d) the broadening in the range of enterprises which commercial banks are financing in terms of size, sector of activity, and geographic area; and

(e) a shift from direct to indirect methods of controlling the money supply following successful and sustained macroeconomic stabilization.

(3) Programmatic Conditions Precedent To The First Release

The GOZ will confirm its commitments to continuing financial sector reform and development, and agree to work with USAID and other donors in defining, pursuing and evaluating program performance. These requirements will be formalized as conditions precedent to the release of the first tranche of dollar import funding.

- The GOZ will issue a Financial Development Policy Statement embodying a liberal, private sector oriented approach consistent with the structural adjustment program. The statement will include specifically the following objectives for the financial sector under this program:

  (1) By the end of the program, real financial resources mobilized by private commercial banks should be growing by at least 4 percent per year.

  (2) Interest rates should be positive relative to inflation.

  (3) Commercial banks should be financing a wider range of enterprises than before the program in terms of size, sector of activity, and geographic area.

  (4) The GOZ budget deficit should be financed from the market at market rates of interest, rather than monetarily at near zero interest as at present.

  (5) No GOZ constraints should remain on bank interest rates or fee structures.

  (6) Required reserves should be set minimum levels necessary for stability of the banking system.

(7) Required reserve deposits should be remunerated at market rates.

(8) The Central Bank should be acting only as lender of last resort and should charge market-based interest rates.

(9) The GOZ should be moving to replace administrative credit ceilings (direct controls) with indirect controls on credit that are automatically linked to mobilization of resources by the banking system.

o The GOZ will name the representatives to regular bi-annual consultations with USAID in the context of the PSSP on the content and implementation of the Financial Sector Program.

(4) Conditions Precedent To Subsequent Releases

AID will obligate funds to the project annually. Decisions on subsequent releases of dollar import funding shall be made twice annually in the context of GOZ-AID bi-annual consultations on the progress in the financial sector reform program. The first of these consultations would occur in December 1988 following IMF and World Bank supervisory missions on the structural adjustment program.

In these consultations, the GOZ and AID would review performance in fulfilling conditions precedent, consider overall progress in financial sector development, and establish expected performance for the next period.

Given the current state of development of the financial sector reform program and plans for reform measures by the GOZ, AID would expect the following conditions to have been achieved by the time of first six-month consultative meeting:

--- Gap between BDZ exchange rate and uncontrolled market rates of no more than 20 percent.

--- Inflation rate no more than 75 percent.

--- Gap between inflation and BDZ's lending interest rate in the money market reduced to no more than 35 percentage points. For example, if inflation rate does not fall below 75 percent by the end of 1988, BDZ's nominal lending rate in the money market must increase above the April, 1988 rate of 35 percent. Interest rates on BDZ rediscounts and advances to commercial banks must equal or exceed the money market interest rate.

--- Reserve requirement of 10 percent or less on deposits of more than 3 and less than 6 months. Reserve requirement of 5 percent or less on deposits of 6 months or more.

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--- Reduction of total commercial bank obligations to the BDZ as a proportion of required reserves by at least 5 percentage points relative to the level of December 31, 1987.

USAID does not wish to establish these specific targets as conditions precedent to the second release because meeting these specific targets requires changes in a number of exogenous factors. Some of these exogenous factors may be outside the control of the GOZ. If the GOZ was unable to meet one or two of these specific targets but was still judged to be making sufficient progress toward the major financial sector objectives, AID would wish to have the flexibility to approve a release. Applying these targets as rigid conditions would remove this flexibility.

However, the second and subsequent releases of dollar import funds would be based on the GOZ's meeting satisfactorily two conditions:

(1) The GOZ will undertake those measures agreed upon with AID during the bi-annual GOZ/AID project consultations to execute financial sector reforms, including but not limited to those identified in the Financial Sector Development Policy Statement for the purpose of:

(a) promoting the mobilization by commercial banks of domestic financial resources and private savings;

(b) fostering a more active money market and interest rates more representative of the real economic cost of funds; and

(c) increasing the amount of credit in real terms available to the private sector.

(2) The GOZ will demonstrate during the regular GOZ/AID project consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the project.

(5) <u>Establishment And Interpretation of Benchmarks</u>

Benchmarks will be established to assess progress towards measurable objectives. While the fundamental objective of the PSSP will remain private sector growth, two specific underlying problems have been identified for which solutions can be found and progress towards objectives measured. These are mobilization of resources by the financial sector, and efficient allocation of these resources to the private sector.

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o <u>Increased Mobilization Of Private Domestic Resources By The Financial Sector</u>

The PSSP will monitor the change in real value of private deposits in the commercial banks. The exact nature of the deposits to be calculated and a method for deflating current values to calculate real growth will be determined and agreed upon in the GOZ/AID consultative meetings and through PSSP-funded studies, if necessary.

o <u>Efficiency In Allocation Of Domestic Financial Resources To The Private Sector</u>

The PSSP will monitor the real cost of funds to the banking sector, in particular the rate of interest in the money market relative to the rate of inflation. The proposed benchmarks for progress in the reduction of the gap between inflation and the money market would be set at the bi-annual GOZ/A.I.D. consultations and would be based on likely and possible progress during the next period. The objective would be the return to positive interest rates relative to inflation as soon as is feasible. These benchmarks would not be proposed as conditions precedent to fund disbursement. They are meant to serve as quantitative indicators of whether overall economic environment and development measures are achieving results. The GOZ would, however, be asked to commit itself to seek measures to improve the structure and incentives in the financial sector to help achieve PSSP objectives. USAID would agree to commit additional funds to the project after each six-month review, provided the GOZ continued to make good-faith efforts to devise and install measures needed to improve performance of the financial sector relative to the benchmarks.

(6) <u>Further Financial Sector Studies And Reform Measures</u>

The PSSP will provide for a number of financial sector studies which will be undertaken during the course of the program under consultation with the GOZ. The results of these studies will be used to establish additional and improved benchmark monitoring measures and to suggest additional performance conditions where required. Studies will include some of the following topics:

o Methods for measurement of real interest rates (RIR) and growth in real bank deposits.

o Offsetting reduced BDZ lending to banks with reduced reserve requirements: cost and benefits.

o Exclusion of agricultural campaign credit from credit ceilings: cost and benefits.

o Direct BDZ financing of the budget deficit: cost and benefits.

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- o Pre-conditions required for replacement of administrative credit ceilings by indirect controls.

Bi-annual program reviews with the GOZ will be used to determine the actual studies undertaken and to develop additional reform measures as the program unfolds.

(7) GOZ-USAID Coordination Of The PSSP

Since the PSSP is to be implemented over a five-year period, a formal mechanisms will be established to ensure coordination of the government's medium term financial sector development programs - FSAC and SAL II - with the PSSP. The project agreement in one of the programmatic conditions precedent would provide for twice-yearly GOZ-USAID meetings to include the Bank of Zaire. These meetings would review and consider the following:

- o The performance of the financial sector relative to agreed benchmarks.
- o The reasons for satisfactory or unsatisfactory performance relative to these benchmarks: to include contribution of policy measures and the impact of exogenous events.
- o Implementation status of previously adopted measures.
- o Disbursements and recoveries of PSSP private sector loans.
- o Impact of PSSP financing on both the financial sector and private enterprises.
- o Status of policy studies or project interventions.
- o Additional measures required for the success of the program.

Meetings would normally be scheduled after GOZ- World Bank/IMF meetings on policy-based lending programs in order to utilize macroeconomic and financial information normally prepared in advance of such meetings.

(8) Long-Term Objectives For The Financial Sector Policy Environment

Studies and monitoring of the progress of both the lending and policy elements of the PSSP will be necessary to identify and negotiate further measures. USAID's long-term vision of the policy environment governing bank credit and mobilization of resources would be characterized by:

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--- Control of aggregate liquidity through indirect means (control over the monetary base) rather than through direct administrative credit controls.

--- Financing of the Treasury's needs primarily through borrowing from the public (including financial institutions) at market interest rates, rather than from the central bank.

--- An independent central bank monetary policy centering on stability in nominal aggregate demand.

--- Minimal prudent required reserves in interest-bearing form, along with prudent supervisory controls of the banking system's capitalization and risk exposure.

--- Absence of administrative controls on interest rates, credit allocations, exchange rates, or banking fees and commissions.

(9) The PSSP's Interest Rate Policy

At regular consultations between AID and the GOZ, project authorities will set the interest rate on project funds lent to the private sector. The rate of interest will at least equal the prevailing rate of interest charged by commercial banks for short-term loans and will take into consideration projections of future inflation. Interest will accrue periodically to the outstanding balance of each loan and will be compound interest. The project will offer borrowers the option of capitalization of interest in early payments, to be reimbursed in later payments, in order to take account of the effects of inflation when multiple payments are called for in the loan agreement. This interest rate will remain fixed for all remaining payments.

3.6 Notes

1. See the series of World Bank Economic Memoranda on Zaire, appearing in 1975, 1977, 1979, 1981, 1983, and 1985.

2. See Exhibit 3.14: Zaire's External Terms of Trade. The external terms of trade are the quantity of imports that can be bought in world markets for a given quantity of Zairian exports, on the basis of the usual commodity pattern of imports and exports.

3. Young, Crawford and Thomas Turner, The Rise and Decline of t he Zairian State, (Madison: The University of Wisconsin Press, 198 5), pp. 296 ff.

The World Bank, The Economy of Zaire (Washington, D.C.: 1975) , vol. I, p. 23-32.

The World Bank, Zaire Economic Memorandum: Recent Economic and Sectoral Developments and Current Issues (Washington, D.C.: 1981), vol. II, pp. 139 ff ("Viability of the Refinery").

4. The World Bank, The Economy of Zaire (Washington, D.C.: 1975), vol. II, pp. 55 ff. ("Manufacturing").

5. Ibid., vol. I, pp. 25, 41.

6. See the World Bank's Agriculture and Rural Development Sector Memorandum of May 26, 1981 and the Economic Memorandum of December 20, 1982, vol. II part I on "Agriculture".

7. See IMF document EBS/81/126, June 8, 1981.

8. See IMF, document EBS/83/257, November 30, 1983.

9. The "effective rate of protection" means the percentage change in domestic value added at local prices resulting from the whole system of currency valuation, tariffs, and quantitative restrictions (quotas) on imports. For example, an industry with 10 percent import tariff protection ("nominal" protection) may find that its effective protection is negative if imported inputs account for 50 percent of its costs (about the average in Zaire) and the average tariff on those imports is 25 percent. On the other hand, if 90 percent of the inputs were imported and free of tariff, then the 10 percent nominal protection would result in a doubling of domestic value added at local prices, or 100 percent effective protection. Even with no tariffs, industries can have substantial effective protection (including negative effective "protection") depending on overvaluation of the currency and the system of import controls.

10. See IMF, document EBS/83/257, November 30, 1983.

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EXHIBIT 3.1: Growth in Real

| 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|
| -2.2% | 1.2% | 2.8% | 2.5% | 2.7% | 3.2% |

Sources: 1982-85: IMF, EBS/87/86, page 6.
1986-87: Bank of Zaire, Evaluation of GDP in 1987 (French: 2/7/88), page 3.

EXHIBIT 3.2

Table 2: Structure of GDP

| | 1959 | 1972 | 1982 | 1987 |
|---|---|---|---|---|
| Agriculture: Commercial | 18.9% | 8.0% | 13.4% | 9.7% |
| Subsistence | 10.8% | 7.4% | 22.5% | 11.5% |
| Mining | 7.5% | 14.8% | 11.5% | 24.1% |
| Manufacturing | 12.5% | 9.0% | 2.3% | 6.6% |
| Construction and public works | 3.1% | 3.1% | 4.0% | 2.6% |
| Non-commercial construction | | 1.5% | 2.0% | 1.2% |
| Electricity and water | 1.5% | 0.9% | 0.0% | 1.3% |
| Transportation | 7.1% | 8.4% | 1.9% | 5.5% |
| Trade | 7.7% | 13.7% | 21.4% | 12.3% |
| Services | 22.4% | 27.0% | 18.2% | 24.7% |
| Indirect taxation | 8.6% | 6.2% | 2.7% | 0.5% |

Sources:
1987: Bank of Zaire, Evaluation of GDP in 1987, (2/7/88) page 3.
1982: IMF, SM/85/107.
1972: Bank of Zaire, Annual Report 1974, page 49.
1959: Bank of Zaire, Annual Report 1967, page 38.

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EXHIBIT 3.3

Table 3: Balance of Payments

(Millions of SDRs)

| | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|---|
| Sources of FX: | | | | | | |
| -- | | | | | | |
| Exports (fob) | 1,317 | 1,577 | 1,871 | 1,825 | 1,572 | 1,341 |
| Services | 76 | 108 | 138 | 151 | 161 | 157 |
| Official Grants | 170 | 162 | 170 | 196 | 157 | 165 |
| Official Loans | 192 | 136 | 132 | 155 | 230 | 320 |
| Priv Loans & Err/Omiss | (116) | (15) | 83 | 111 | 63 | 159 |
| IMF | | | | | | |
| SAF | 0 | 0 | 0 | 0 | 0 | 58 |
| Stand-By | 107 | 115 | 158 | 169 | 81 | 70 |
| Debt relief | 136 | 909 | 466 | 411 | 462 | 567 |
| TOTAL SOURCES | 1,882 | 2,992 | 3,018 | 3,018 | 2,726 | 2,837 |
| TOTAL USES | 2,227 | 2,992 | 3,018 | 3,018 | 2,726 | 2,836 |
| (New Arrears) | 345 | 0 | 0 | 0 | 0 | 0 |
| Uses of FX: | | | | | | |
| -- | | | | | | |
| Imports (cif) | 1,022 | 1,351 | 1,365 | 1,392 | 1,302 | 1,255 |
| Services | 558 | 513 | 627 | 557 | 486 | 545 |
| Debt repayments | 334 | 320 | 420 | 446 | 410 | 399 |
| Interest | 285 | 272 | 367 | 328 | 333 | 331 |
| IMF: Repayments | 22 | 10 | 54 | 104 | 94 | 125 |
| Interest | 24 | 41 | 48 | 56 | 55 | 47 |
| Private outflows | 14 | (3) | 89 | 54 | 53 | 52 |
| Arrears paid | 0 | 480 | 74 | 51 | 24 | 8 |
| Reserves | (32) | 8 | (26) | 30 | (31) | 74 |

Sources: 1985-87: IMF, Aide Mémoire, Table 4 (French, 2/22/88).
1983-84: IMF, EBS/87/86, Table 4 (4/22/87).
1982: IMF, EBS/83/257, Table 3 (11/30/83).

EXHIBIT 3.4

Table 4: Sources of Growth in the Monetary Base

(millions of current zaires)

| | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|
| Monetary Base Sources | 15,660 | 19,999 | 32,111 | 64,490 |
| Monetary Financing of Deficit | 13,657 | 14,957 | 25,043 | 50,766 |
| Bank of Zaire | 13,404 | 14,680 | 20,854 | 28,477 |
| Comm. Banks (T. bills in RR) | 253 | 277 | 4,189 | 4,929 |
| Counterpart Funds - SALs | 0 | 0 | 0 | 17,360 |
| Commercial Bank Borrowing | 1,148 | 2,182 | 3,730 | 15,225 |
| Discounting | 1,148 | 2,182 | 1,216 | 5,081 |
| Money Market | 0 | 0 | 2,514 | 7,858 |
| Others | 0 | 0 | 0 | 2,286 |
| External Account Contributions | 855 | 2,860 | 3,338 | (1,501) |

Source: Bank of Zaire data provided to the World Bank and USAID.

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EXHIBIT 3.5

Table 5: Exports

| | (millions of dollars) | | | | | |
|---|---|---|---|---|---|---|
| | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
| Copper | $790.7 | $822.0 | $670.5 | $711.8 | $694.8 | $839.7 |
| Volume | 542.6 | 525.6 | 482.2 | 506.8 | 503.0 | 507.2 |
| Cents/lb | 66.1 | 71.0 | 63.1 | 63.7 | 62.7 | 75.1 |
| Cobalt | $182.8 | $120.8 | $236.2 | $235.7 | $149.7 | $132.6 |
| Volume | 7.3 | 9.5 | 12.6 | 9.3 | 14.1 | 10.2 |
| $/lb | 10.0 | 5.8 | 8.5 | 11.5 | 4.8 | 5.9 |
| Zinc | $43.1 | $50.2 | $53.3 | $49.1 | $48.3 | $37.3 |
| Volume | 55.0 | 66.6 | 63.0 | 70.7 | 71.9 | 51.6 |
| $/lb | 35.6 | 34.0 | 38.4 | 31.5 | 30.5 | 32.8 |
| Silver | $18.0 | $11.8 | $6.7 | $6.5 | $7.7 | $6.5 |
| Volume | 71.8 | 33.1 | 25.4 | 27.0 | 44.9 | 31.0 |
| $/ounce | 7.1 | 11.3 | 8.5 | 7.7 | 5.5 | 6.7 |
| Gold | $23.1 | $72.7 | $60.2 | $31.2 | $26.6 | $40.3 |
| Volume | 2.0 | 5.3 | 6.0 | 2.9 | 2.8 | 3.3 |
| ($/oz) | 361.9 | 426.7 | 322.6 | 345.9 | 355.2 | 379.8 |
| Diamonds | $76.2 | $139.0 | $217.0 | $199.1 | $228.5 | $197.2 |
| Unit value | 6.7 | 11.7 | 18.1 | 19.6 | 23.3 | 19.6 |
| ($/car) | 11.3 | 11.9 | 12.0 | 10.2 | 10.6 | 10.1 |
| Crude oil | $274.3 | $236.2 | $330.3 | $300.8 | $146.5 | $192.2 |
| Volume | 8.1 | 8.5 | 12.1 | 12.0 | 10.7 | 11.5 |
| ($/brl) | 33.9 | 28.0 | 27.3 | 25.1 | 12.5 | 16.6 |
| Coffee | $105.0 | $116.5 | $211.6 | $153.6 | $437.3 | $168.7 |
| Volume | 68.0 | 69.5 | 78.9 | 65.5 | 145.8 | 104.8 |
| ($/lb) | 0.70 | 0.76 | 1.22 | 1.06 | 1.36 | 0.73 |
| Rubber | $11.5 | $15.0 | $10.6 | $7.5 | $7.8 | $10.3 |
| Volume | 14.9 | 15.9 | 14.6 | 11.0 | 13.9 | 10.6 |
| ($/lb) | 0.35 | 0.42 | 0.33 | 0.31 | 0.25 | 0.44 |
| Others | $93.0 | $101.6 | $121.6 | $156.9 | $98.1 | $95.0 |
| TOTAL (fob) | $1,617.7 | $1,685.8 | $1,918.0 | $1,852.2 | $1,845.3 | $1,719.8 |

Sources: 1986-87: Bank of Zaire, The Economic and Financial Situation in Zaire in 1987: Structure of Exports, 1986-88.
1983-85: IMF, EBS/87/86, p. 92.
1982: IMF, EBS 83/257, Appendix VI (11/30/83).

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EXHIBIT 3.6

Table 6: GOZ Fiscal Performance

1986

(millions of zaires)

| | Program | Actual |
|---|---|---|
| Revenue | 52,100 | 45,260 |
| Income and Profit Taxes | 16,000 | 15,676 |
| Taxes on Goods and Services | 14,015 | 8,444 |
| Taxes on International Trade | 19,285 | 17,446 |
| Import Duties | 11,110 | 11,141 |
| Export Duties | 8,175 | 6,305 |
| Other Revenues | 2,800 | 3,694 |
| Budget pour Ordre | 1,800 | 781 |
| Administrative Receipts | 1,000 | 1,464 |
| Other | 0 | 1,449 |
| Expenditure | 50,240 | 50,814 |
| Wages and Salaries | 8,500 | 11,628 |
| Goods and Services | 9,000 | 10,936 |
| Interest on Public Debt | 23,040 | 19,723 |
| Domestic | 5,800 | 7,204 |
| Foreign | 17,240 | 12,519 |
| Transfers and Other Subsidies | 1,550 | 1,387 |
| Investment | 2,100 | 1,039 |
| Arrears | 4,250 | 5,534 |
| Gecamines | 1,400 | 1,279 |
| Domestic | 1,600 | 3,084 |
| External | 1,250 | 1,171 |
| Other Expenditures | 1,800 | 1,386 |
| Budget pour Ordre | 1,800 | 682 |
| Other | 0 | 704 |
| Net Changes Treas. Subaccts. | 0 | (819) |
| Overall Balance | 1,860 | (5,554) |

Source: IMF, EBS/87/86, page 15.

Table 6 (continued):

GOZ Fiscal Performance - 1987

| | (millions of zaires) | |
|---|---|---|
| | Program | Actual |
| Revenue | 80,571 | 83,933 |
| Internal Taxation | 28,665 | 37,477 |
| Corporate Taxes | 7,290 | 9,127 |
| Personal Income Tax | 5,950 | 10,054 |
| CER | 1,199 | 617 |
| Other | 1,830 | 1,945 |
| Internal Turnover Tax | 5,560 | 7,473 |
| Turnover Tax on Exports | 1,200 | 1,163 |
| Petroleum Taxes | 5,636 | 7,097 |
| Customs | 24,455 | 18,806 |
| Export Taxes | 2,310 | 1,796 |
| Import Taxes | 19,068 | 14,245 |
| Consumption Taxes | 3,037 | 2,721 |
| Others | 40 | 44 |
| Gecamines | 16,200 | 19,405 |
| Other Revenues | 11,251 | 8,246 |
| Budget pour Ordre | 6,146 | 531 |
| Administrative Receipts | 2,105 | 2,947 |
| Other | 3,000 | 4,768 |
| Expenditure | 87,171 | 110,179 |
| Wages and Salaries | 18,000 | 20,215 |
| Goods and Services | 14,217 | 22,142 |
| Interest on Public Debt | 30,015 | 28,794 |
| Transfers and Other Subsidies | 1,738 | 2,071 |
| Investment | 5,000 | 4,178 |
| Arrears | 11,255 | 23,050 |
| Gecamines | 4,644 | 5,706 |
| Domestic | 3,889 | 6,573 |
| External | 2,722 | 10,771 |
| Other Expenditures | 6,946 | 4,508 |
| Budget pour Ordre | 6,146 | 594 |
| Other | 800 | 3,914 |
| Net Changes Treas. Subaccts. | 0 | (5,221) |
| Overall Balance | (6,600) | (26,246) |

Source: Bank of Zaire, The Economic and Financial Situation in Zaire in 1987, (Ch. 3, Public Finances): 2/7/88.

Table 6 (concluded):

GOZ Fiscal Performance - 1988, First Quarter

(millions of zaires)

| | Program | Actual |
|---|---|---|
| Revenue | 32,544 | 26,904 |
| Internal Taxation | 13,729 | 11,773 |
| Corporate Taxes | 2,575 | 1,258 |
| Personal Income Tax | 3,674 | 3,634 |
| CER | 650 | 253 |
| Other | 689 | 748 |
| Internal Turnover Tax | 2,252 | 2,654 |
| Turnover Tax on Exports | 612 | 347 |
| Petroleum Taxes | 3,277 | 2,878 |
| Customs | 8,204 | 5,698 |
| Export Taxes | 443 | 436 |
| Import Taxes | 5,583 | 4,540 |
| Consumption Taxes | 2,166 | 709 |
| Others | 12 | 13 |
| Gecamines | 7,365 | 7,201 |
| Internal Taxes | NA | 2,101 |
| Customs Taxes | NA | 5,100 |
| Other Revenues | 3,246 | 2,232 |
| Budget pour Ordre | 0 | 0 |
| Administrative Receipts | 2,696 | 732 |
| REP | 550 | 0 |
| Other | 0 | 1,500 |
| Expenditure | 33,785 | 30,842 |
| Wages and Salaries | 8,425 | 5,916 |
| Goods and Services | 8,315 | 6,299 |
| Interest on Public Debt | | |
| Domestic | 10,086 | 9,378 |
| Foreign | 2,571 | 394 |
| Transfers and Other Subsidies | 1,192 | 1,260 |
| Investment | 1,951 | 1,407 |
| Arrears | 1,246 | 6,188 |
| Net Other Accounts | 0 | 2,545 |
| Overall Balance | (1,242) | (1,393) |

Source: Bank of Zaire, Economic and Financial Situation in Zaire, First Quarter 1988 (April, 1988).

EXHIBIT 3.7

Table 7: Zaire's Stand-By Agreements with the IMF

| Dates | Amount in SDRs million | |
|---|---|---|
| | Agreed | Drawn |
| March, 1976 - March, 1977: | 41 | 41 |
| April, 1977 - April, 1978: (abandoned, November, 1977) | 45 | 5 |
| August, 1979 - February, 1981: | 118 | 118 |
| June, 1981 - June, 1984 (EFF): (canceled June, 1982) | 912 | 175 |
| December, 1983 - March, 1985: | 228 | 198 |
| April, 1985 - April, 1986: | 162 | 162 |
| May, 1986 - March, 1988: (abandoned February, 1987) | 214 | 48 |
| May, 1987 - May, 1988: (abandoned February, 1988) | 143 | 30 |

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EXHIBIT 3.8

Table 8: Official Devaluations of the Zaire

| | Devaluation | New Rate | Notes |
|---|---|---|---|
| 1967......... | 67 percent | $ 2.00 | Officially in terms of gold |
| 1968......... | | | |
| 1969......... | | | |
| 1970......... | 0 percent | $ 2.00 | Officially in terms of the dollar |
| 1971......... | | | |
| 1972......... | | | |
| 1973......... | | | |
| 1974......... | | | |
| 1975......... | | | |
| 1976......... | 42 percent | SDR 1.00 | Officially in terms of the SDR |
| 1977......... | | | |
| 1978......... | 11 percent | SDR 0.90 | |
| 1979......... | 44 percent | SDR 0.50 | In two steps at the end of 1978 |
| | 25 percent | SDR 0.375 | |
| 1980......... | 30 percent | SDR 0.2625 | |
| 1981......... | | | |
| | 40 percent | SDR 0.1575 | |
| 1982......... | | | |
| 1983......... | | | |
| | 78 percent | SDR 0.03542 | Floating thereafter |

EXHIBIT 3.9

Table 9: Financing the GOZ's Budget Deficit

(millions of zaires)

| | 1984 | 1985 | 1986 | 1987 | 1988:I |
|---|---|---|---|---|---|
| Budgetary Revenues | 27,289 | 43,342 | 50,931 | 87,394 | 29,449 |
| Budgetary Expenditures | 30,901 | 44,889 | 61,585 | 113,638 | 30,842 |
| Budgetary Surplus | (3,612) | (1,547) | (10,654) | (26,244) | (1,393) |
| Budgetary Financing | 3,610 | 1,550 | 10,655 | 26,244 | 1,393 |
| Banking System | 3,041 | 1,300 | 10,087 | 25,723 | (941) |
| BOZ | 2,994 | 1,276 | 6,174 | 7,623 | (2,941) |
| Commercial Banks | 47 | 24 | 3,913 | 740 | .. |
| Counterpart Funds - PBLs | 0 | 0 | 0 | 17,360 | 2,000 |
| Treasury Securities | 569 | 250 | 568 | 521 | 2,334 |
| Treasury Bills | 569 | 250 | 90 | 595 | 2,334 |
| Lottery Securities | 0 | 0 | 478 | (74) | .. |

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Table 10: Commercial Bank Sector Balance Sheet

(millions of zaires)

| | 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|
| TOTAL ASSETS | 9,416 | 14,199 | 18,172 | 30,195 | 68,866 |
| Foreign Assets | 3,298 | 3,019 | 4,323 | 7,422 | 16,501 |
| Domestic Assets | 6,118 | 11,180 | 13,849 | 22,773 | 52,365 |
| Reserves | 3,110 | 6,456 | 7,048 | 12,485 | 26,915 |
| Currency | 260 | 659 | 885 | 1,418 | 2,215 |
| Deposits in BOZ | 2,850 | 5,797 | 6,163 | 11,067 | 24,700 |
| Domestic Credit | 3,008 | 4,724 | 6,801 | 10,288 | 25,450 |
| Private Sector | 2,832 | 4,471 | 6,515 | 9,648 | 22,932 |
| GOZ | 176 | 253 | 286 | 640 | 2,518 |
| TOTAL LIABILITIES | 9,417 | 14,200 | 18,172 | 30,195 | 68,867 |
| Foreign Liabilities | 744 | 511 | 1,002 | 3,093 | 6,355 |
| Domestic Liabilities | 8,673 | 13,689 | 17,170 | 27,102 | 62,512 |
| Borrowing | 573 | 1,148 | 2,182 | 3,730 | 15,225 |
| Discounting | 573 | 1,148 | 2,182 | -- | 5,081 |
| Money Market | 0 | 0 | 0 | -- | 7,858 |
| Others | 0 | 0 | 0 | -- | 2,286 |
| Deposits | 7,213 | 9,483 | 11,576 | 19,237 | 40,281 |
| Private Deposits | 7,121 | 9,459 | 11,483 | 19,069 | 38,975 |
| Demand Deposits | 6,236 | 8,218 | 9,927 | 16,515 | 32,123 |
| Time Deposits | 676 | 995 | 1,047 | 1,855 | 5,042 |
| FX Deposits | 209 | 246 | 509 | 699 | 1,810 |
| GOZ Deposits | 92 | 24 | 93 | 168 | 1,306 |
| Import Prepayment | 248 | 184 | 1,288 | 1,813 | 3,626 |
| Capital Accounts | 778 | 1,406 | 2,185 | 4,729 | 5,427 |
| Other Items Net | (139) | 1,468 | (61) | (2,407) | (2,047) |

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EXHIBIT 3.11

Table 11: Monetary Survey

(billions of zaires)

| | 1983 | 1984 | 1985 | 1986 | 1987 | 1988:I |
|---|---|---|---|---|---|---|
| Net Foreign Assets (broad) | (13.5) | (16.7) | (38.5) | (54.5) | (96.7) | (109.3) |
| Net Foreign Assets (narrow) | (10.5) | (13.9) | (36.2) | (48.6) | (86.6) | (99.7) |
| Foreign Assets | 11.9 | 16.4 | 13.2 | 27.1 | 57.2 | 70.1 |
| Foreign Liabilities | (22.4) | (30.3) | (49.4) | (75.7) | (143.8) | (169.8) |
| (Provision for Arrears) | (5.6) | (5.0) | (4.0) | (3.4) | (5.9) | (6.5) |
| Other Net Foreign Assets | (3.0) | (2.8) | (2.4) | (5.8) | (10.2) | (9.6) |
| Net For'n. Curr. Deposits | (0.3) | (0.4) | (0.8) | (0.9) | (2.2) | 0.0 |
| Provision for Imports | (2.7) | (2.4) | (1.6) | (4.9) | (7.9) | 0.0 |
| Net Domestic assets | 14.1 | 19.3 | 24.5 | 39.1 | 62.3 | 58.2 |
| Net Claims on Government | 10.3 | 13.4 | 14.8 | 24.9 | 33.3 | 27.8 |
| Credit to Enterpr. & Hsehlds | 2.9 | 4.6 | 7.0 | 11.4 | 25.1 | 27.8 |
| Other Net Domestic Assets | 1.0 | 1.3 | 2.7 | 2.8 | 3.9 | 2.6 |
| OVERALL NET ASSETS | 0.7 | 2.7 | (14.0) | (15.3) | (34.4) | (51.2) |
| OVERALL NET LIABILITIES | 0.7 | 2.7 | (14.0) | (15.3) | (34.4) | (51.2) |
| Money Supply (M2) | 13.7 | 18.4 | 23.9 | 38.0 | 74.7 | 82.5 |
| Money (M1) | 13.0 | 17.4 | 22.9 | 36.1 | 69.7 | 76.8 |
| Currency in Circulation | 6.1 | 8.8 | 12.3 | 19.0 | 36.4 | 43.1 |
| Demand Deps. (Comm. Banks) | 6.2 | 8.2 | 9.9 | 16.5 | 32.1 | 33.7 |
| Demand Deps. (BOZ & CCP) | 0.7 | 0.4 | 0.7 | 0.6 | 1.2 | 0.0 |
| Quasi-Money | 0.7 | 1.0 | 1.0 | 1.9 | 5.0 | 5.7 |
| Time Deposits (Comm. Banks) | 0.7 | 1.0 | 1.0 | 1.9 | 5.0 | 0.0 |
| Time Deposits (BOZ) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Items Net | (13.0) | (15.8) | (37.9) | (53.3) | (109.1) | (133.7) |
| Gains & Losses | (21.2) | (27.2) | (43.2) | (60.8) | (125.1) | (152.9) |
| Counterpart | 2.4 | 3.4 | 5.3 | 7.5 | 16.0 | 19.2 |
| Discrepancies | 5.8 | 8.0 | 0.0 | (0.0) | 0.0 | 0.0 |

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EXHIBIT 3.12

Table 12: Elements of Controlled Fuel Prices

| January 14, 1988 | GASOLINE West | GASOLINE East | DIESEL West | DIESEL East |
|---|---|---|---|---|
| | (zaires per ton) | | | |
| TOTAL : 55.700 m3 /T.M./ mo. | 9200 m3 | 300 m3 | 32500 m3 | 2800 m3 |
| 1 Cost at the Border (PMF) | 19,937.00 | 45,901.00 | 20,984.00 | 45,901.00 |
| 2 Transport & storage cost SOZIR | 1,068.00 | | 1,068.00 | |
| 3 Bank charges (5.2% PMF) | 1,036.72 | 2,386.85 | 1,091.17 | 2,386.85 |
| 4 Loss in transport (0.3% PMF) | 59.81 | 137.70 | 62.95 | 137.70 |
| 5 Import tariff | 50.00 | 50.00 | 20.00 | 20.00 |
| 6 Consumption tax | 600.00 | 600.00 | 130.00 | 130.00 |
| 7 Supply | 12.00 | 12.00 | 12.00 | 12.00 |
| 8 Tax | 100.00 | 100.00 | 100.00 | 100.00 |
| 9 TOTAL Price ex-Customs (PMGD) | 22,863.54 | 49,187.56 | 23,468.12 | 48,687.56 |
| 10 Stabilization Account | 4,500.00 | 4,500.00 | 4,500.00 | 4,500.00 |
| 11 Losses MEP (1% PMGD for gas, 0.5% for diesel) | 228.64 | 491.88 | 117.34 | 243.44 |
| 12 Operating costs SEP | 3,565.00 | 1,339.00 | 3,941.00 | 2,140.00 |
| 13 Operating costs, fuel distrbtrs. | 5,245.00 | 1,795.00 | 1,329.00 | 1,616.00 |
| 14 Operating costs, SOZIR | 1,021.00 | 0.00 | 1,021.00 | 0.00 |
| 15 Margin (10% PMGD) | 2,286.35 | 4,918.76 | 2,346.81 | 4,868.76 |
| 16 TOTAL COST OF DISTRIBUTION | 16,845.99 | 13,044.63 | 13,255.15 | 13,368.19 |
| 17 Roads tax | 7,793.77 | 0.00 | 7,793.77 | 0.00 |
| 18 River tax | 0.00 | 0.00 | 259.23 | 0.00 |
| 19 Farm-to-market roads tax | 500.00 | 0.00 | 1,000.00 | 0.00 |
| 20 Special Treasury Fund no. 1 | 3,104.99 | 0.00 | 0.00 | 0.00 |
| 21 Special Treasury Fund no. 2 | 8,349.48 | (7,123.56) | 5,829.35 | (4,275.55) |
| 22 TOTAL PARAFISCAL TAXES | 19,748.24 | (7,123.56) | 14,882.35 | (4,275.55) |
| 23 Real Reference Price | 59,457.76 | 55,108.63 | 51,606.00 | 57,780.20 |
| 24 Reference Price applied | 59,000.00 | 55,000.00 | 52,000.00 | 58,000.00 |

Source: GOZ Ministry of National Economy and Industry, Departmental Decree No. DENI/CAB/06/001/88 of January 13, 1988.

EXHIBIT 3.13

Table 13: Bank of Zaire Balance Sheet

| | (millions of zaires at end of year) 1983 | 1984 | 1985 | 1986 | 1987 |
|---|---|---|---|---|---|
| TOTAL ASSETS | 19,951 | 28,119 | 26,699 | 50,847 | 94,774 |
| Foreign Assets (21) | 8,597 | 13,416 | 8,889 | 19,674 | 42,601 |
| Domestic Assets | 11,354 | 14,703 | 17,810 | 31,173 | 52,173 |
| Claims on GOZ | 10,701 | 13,404 | 15,158 | 25,653 | 35,310 |
| Credit to Economy | 80 | 151 | 470 | 1,790 | 1,638 |
| Private non-financial | 0 | 39 | 133 | 1,213 | 1,458 |
| Pub. Inst. non-fin. | 78 | 75 | 171 | 243 | 221 |
| Fin. Inst. non-bank | 2 | 37 | 166 | 334 | 401 |
| Claims on Banks | 573 | 1,148 | 2,182 | 3,730 | 15,225 |
| Discounting | 573 | 1,148 | 2,182 | -- | 5,081 |
| Money Market | 0 | 0 | 0 | -- | 7,858 |
| Others | 0 | 0 | 0 | -- | 2,286 |
| TOTAL LIABILITIES | 19,951 | 28,117 | 26,699 | 50,847 | 94,774 |
| Foreign Liabilities (16c) | 21,668 | 29,801 | 48,379 | 72,645 | 138,789 |
| Domestic Liabilities | (1,717) | (1,684) | (21,680) | (21,798) | (44,015) |
| Monetary Base | 9,912 | 15,659 | 19,999 | 32,110 | 64,490 |
| Currency outside banks | 6,136 | 8,802 | 12,294 | 18,987 | 36,421 |
| Currency in banks | 260 | 659 | 885 | 1,418 | 2,215 |
| Bank Deposits | 2,850 | 5,797 | 6,163 | 11,067 | 24,700 |
| Other Deposits | 666 | 401 | 657 | 638 | 1,154 |
| GOZ Deposits | 534 | 237 | 504 | 1,190 | 3,224 |
| Other Deposits (15) | 2,493 | 2,373 | 574 | 3,314 | 4,716 |
| FX Deposits | 65 | 119 | 296 | 219 | 399 |
| Import Prepayments | 2,428 | 2,254 | 278 | 3,095 | 4,317 |
| Time Deposits | 0 | 0 | 0 | 0 | 0 |
| Counterpart Funds | 19 | 38 | 83 | 224 | 567 |
| Other Items Net | (14,675) | (19,991) | (42,840) | (58,636) | (117,012) |
| Capital Account | -- | -- | -- | -- | -- |
| Revaluation Account | -- | -- | (43,207) | (60,821) | (125,111) |
| Others | -- | -- | -- | -- | -- |

EXHIBIT 3.14

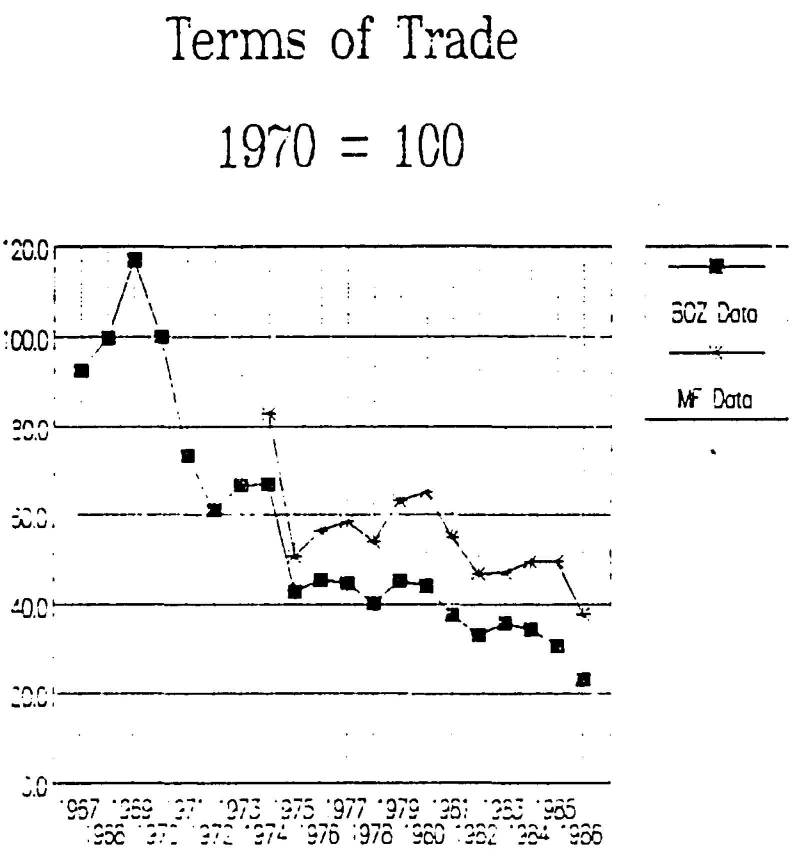


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EXHIBIT 3.15

# Real Per Capita Imports

## Goods and Services

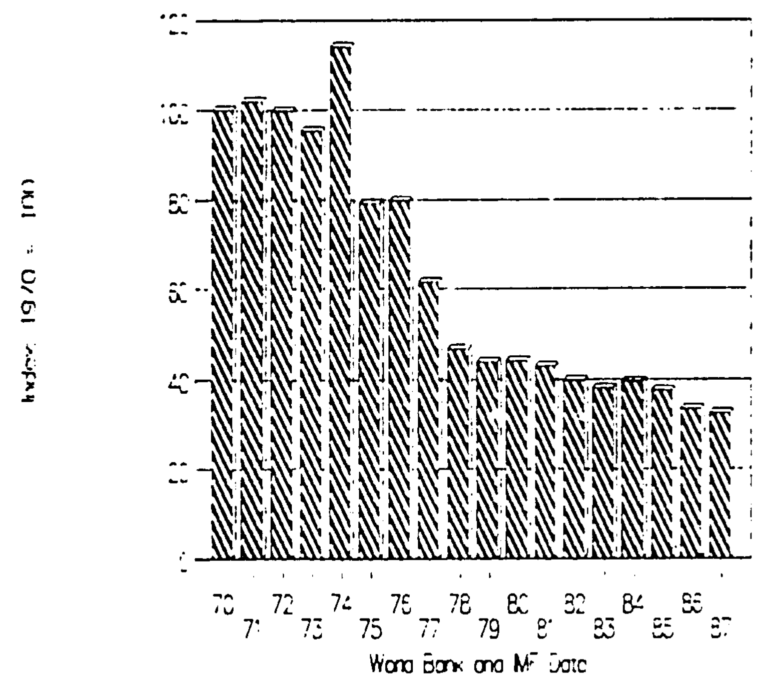


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EXHIBIT 3.16

# Growth in the Money Supply

# (Demand & Time Deposits + Currency)

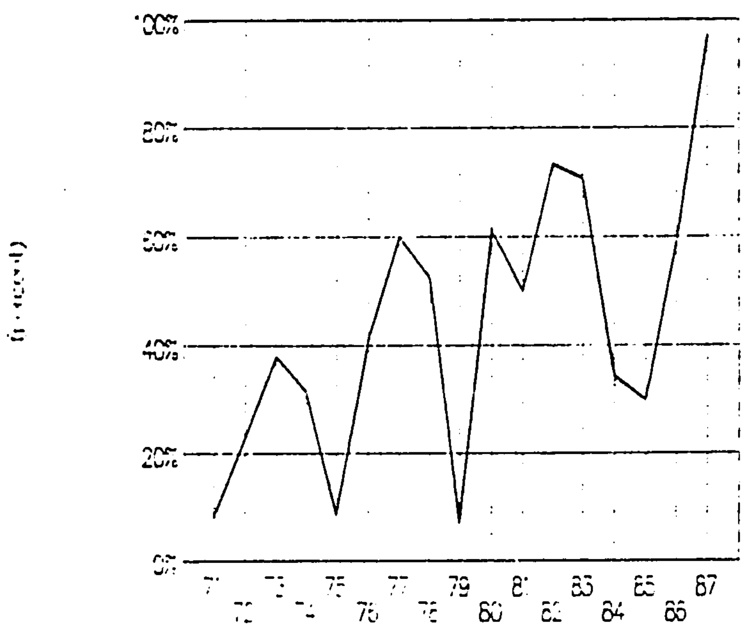


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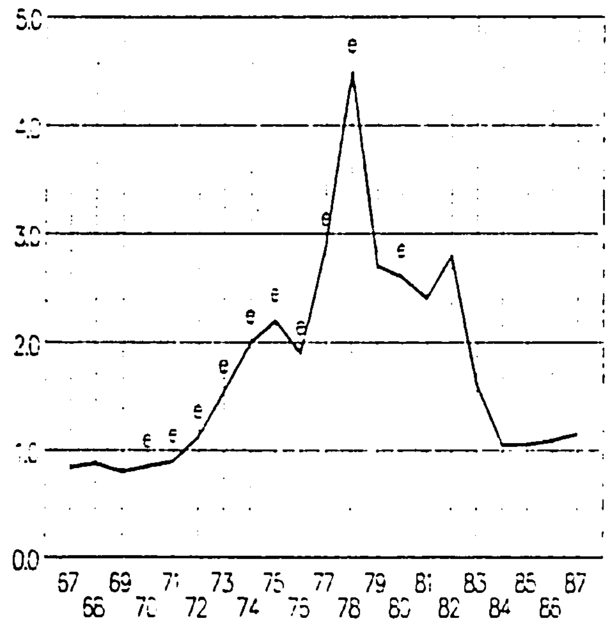
EXHIBIT 3.17

# Overvaluation of the Zaire

## Ratio of Official to Parallel Rates




e = Estimated by Growth of Money Supply

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EXHIBIT 3.18

# GOZ Expenditures on Goods and Services Per Capita, Deflated by GDP Deflator

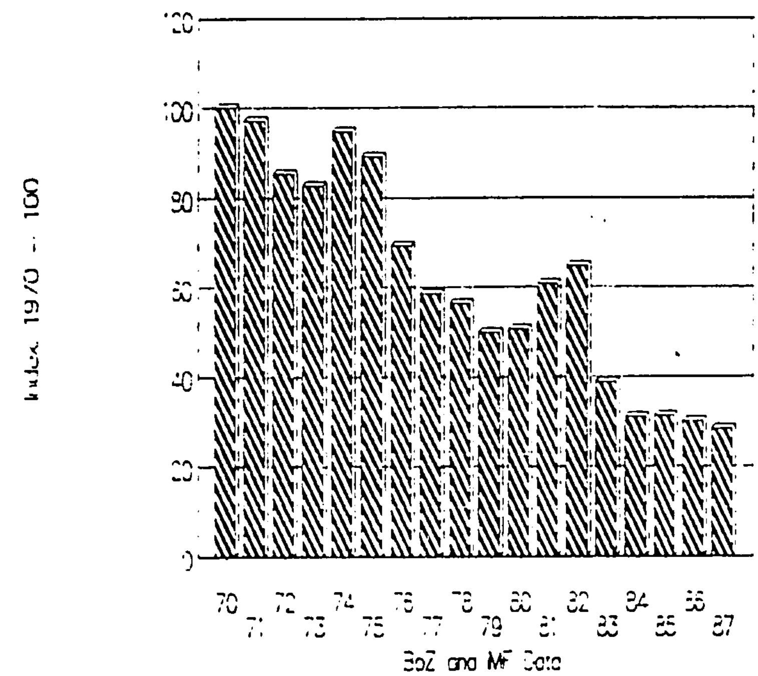

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EXHIBIT 3.19

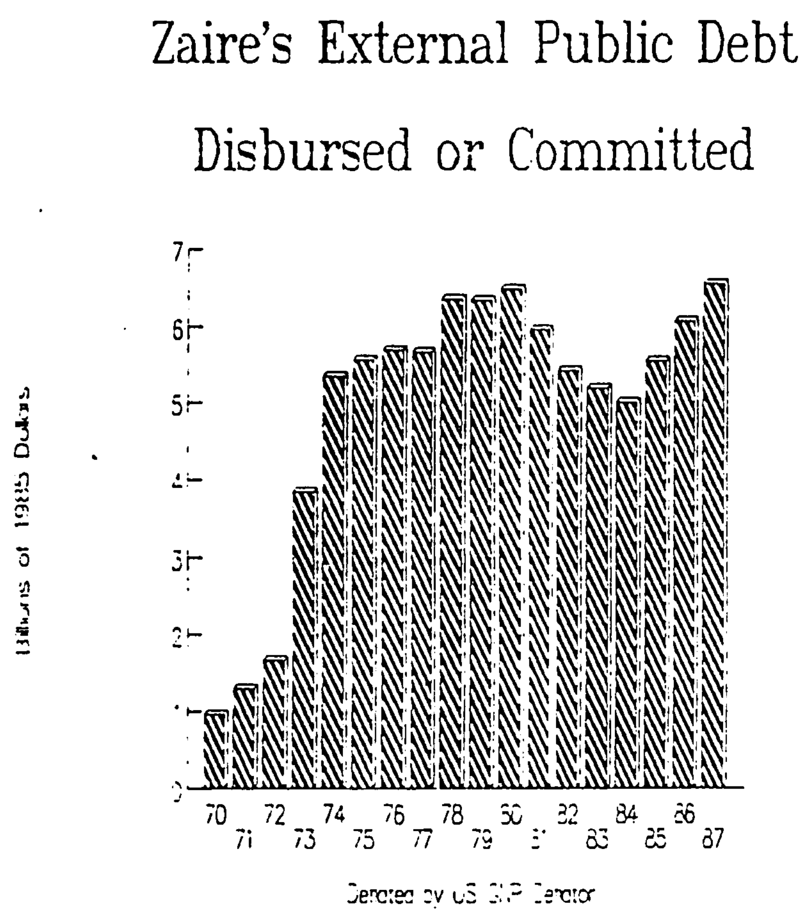


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EXHIBIT 3.20

# Exports Required to Pay Off the Debt

## (Debt Deflated by Export Price Level)

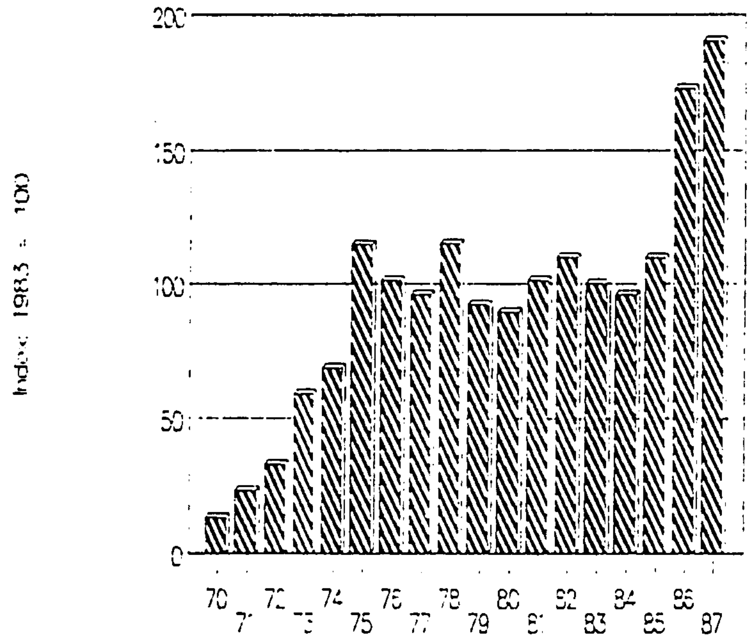


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EXHIBIT 3.21

# Commercial Bank Credit in Real Terms

## End of Year Stock

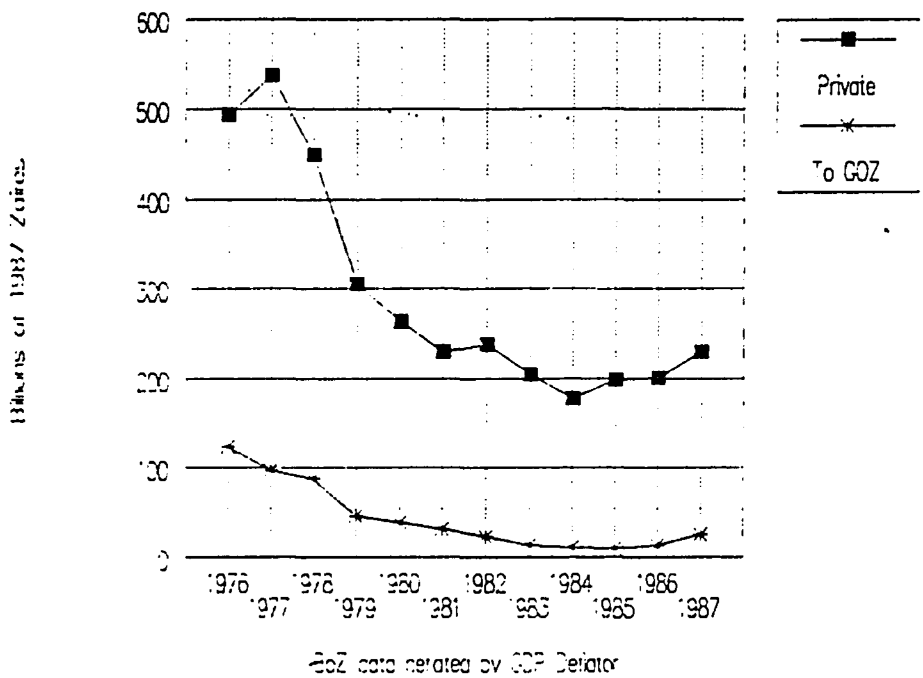


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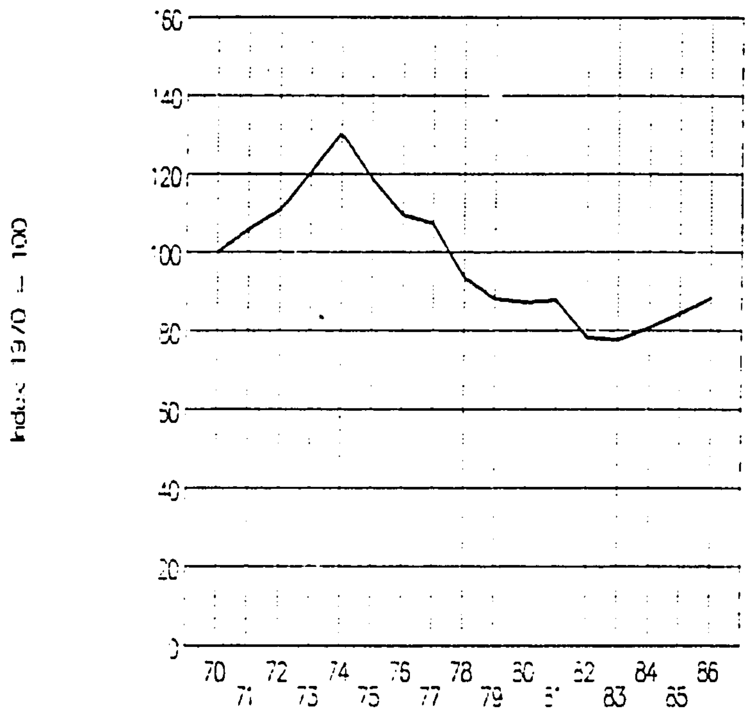
EXHIBIT 3.22

# Industrial Output in Zaire




Source: Bank of Zaire reports.

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**EXHIBIT 3.23**

# Price Inflation

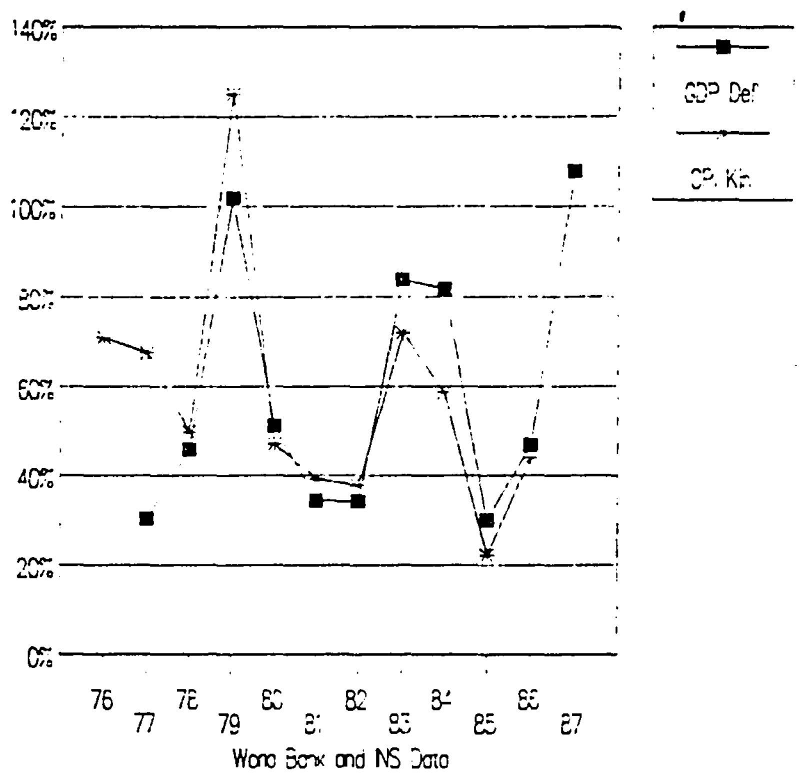

EXHIBIT 3.24

# Real Deposits in Commercial Banks

## End of Year Stock

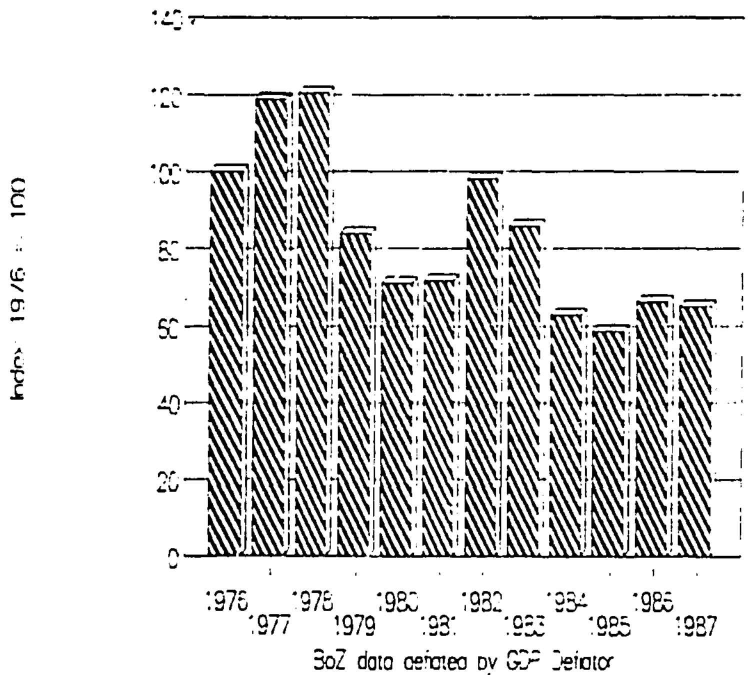


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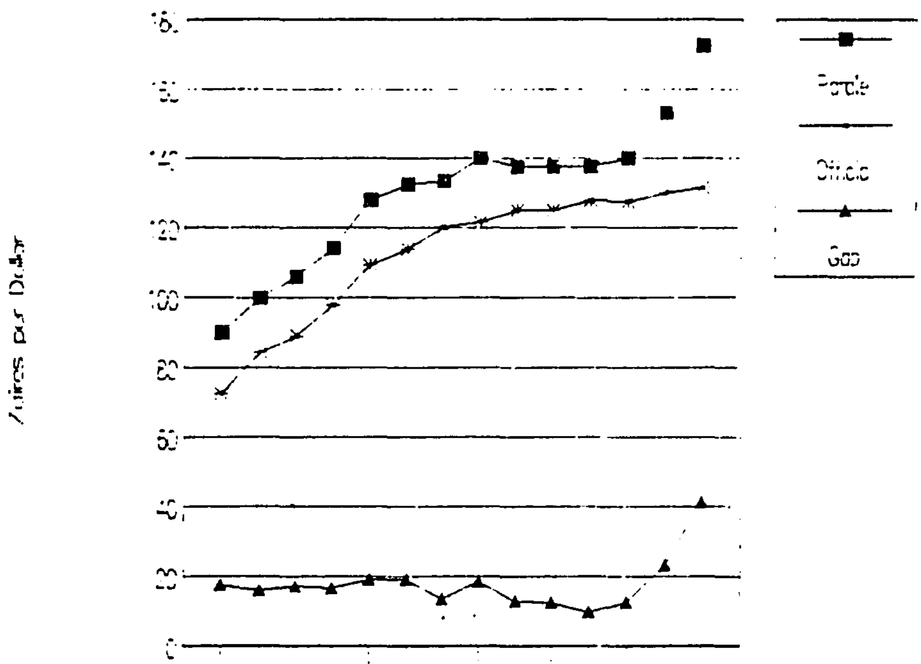
EXHIBIT 3.25

## Periodic Exchange Rates - 1987



Bank of Zaire data

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EXHIBIT 3.26

# The Real Money Supply

## Demand & Time Deposits + Currency

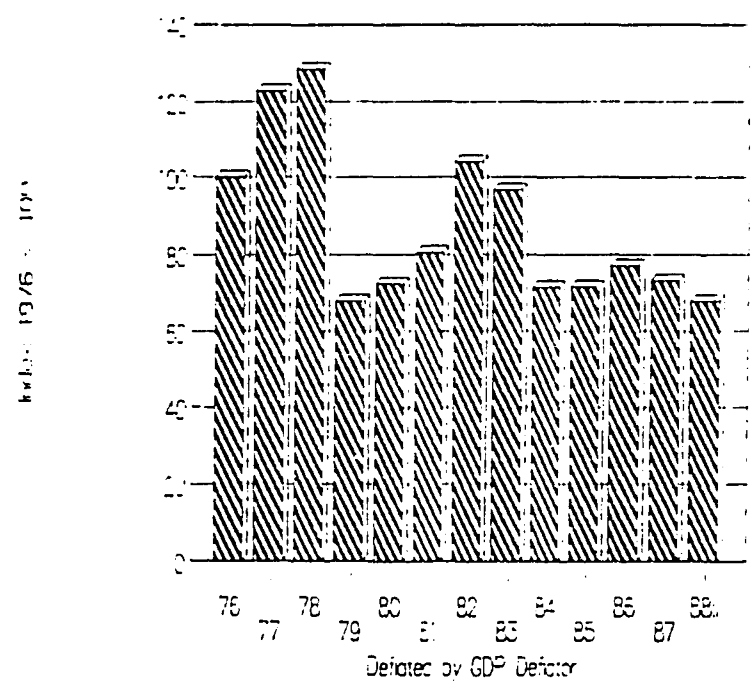


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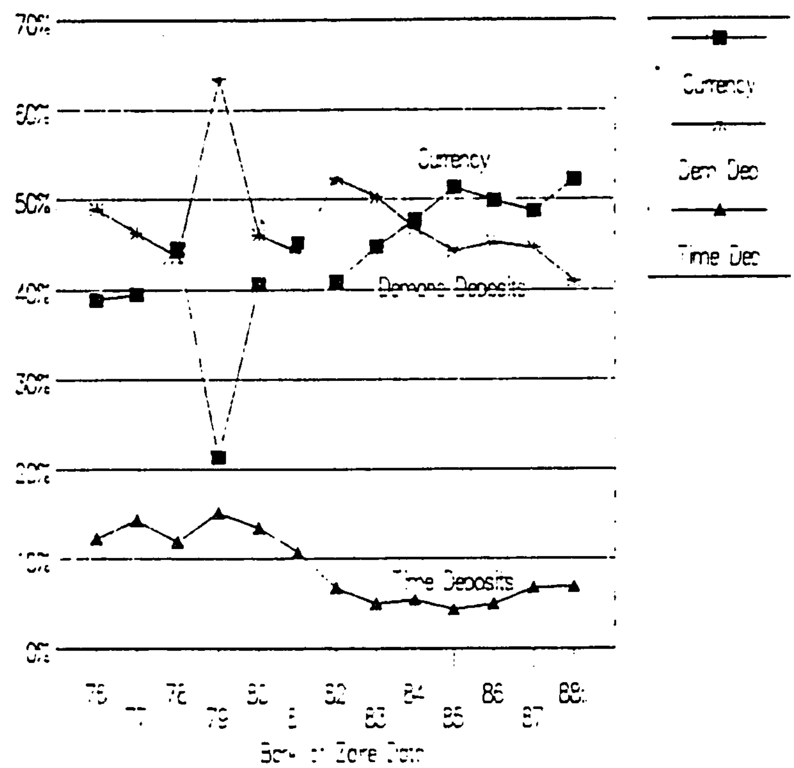
EXHIBIT 3.27

Composition of the Money Supply

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ANNEX 4

SOCIAL SOUNDNESS ANALYSIS

- PRIVATE SECTOR SUPPORT PROGRAM

ANNEX 4

# SOCIAL SOUNDNESS ANALYSIS

## - PRIVATE SECTOR SUPPORT PROGRAM -

### 4.1 Introduction

This Annex examines the overall socio-economic environment within which the PSSP will operate. First, the Annex describes the target beneficiaries of the project, the MSEs, and looks at the major socio-economic trends which affect their functioning. Second, it examines links between the MSEs and non-target beneficiaries. Third, it discusses credit and savings in the informal sector. Fourth, it explores the role of women in the MSEs and in the private sector in general. Fifth, it presents six case studies of MSEs. Finally, it looks at implications for further research. Annex 2, Technical Analysis includes a synopsis of three studies of MSEs carried out by Coopers and Lybrand under contract to USAID/Zaire. Annex 6, Proposed Research, Evaluation and Impact Studies, discusses special studies which will explore ways to reach non-target beneficiaries.

### 4.2 The Target Beneficiaries

#### (1) Medium Scale And Smaller Scale Enterprises

The PSSP will provide access to foreign exchange through the commercial banking system to MSEs for import of raw materials, equipment and spare parts. Through the Counterpart Fund, local currency loans will also be made available to these businesses for purchase of raw materials, spare parts, equipment, and for agricultural campaigns. The studies by Coopers and Lybrand of MSEs in Kinshasa and Lubumbashi enabled the Project team to draw a realistic picture of MSEs in relation to the banking and credit environment. It was discovered that banks are much more likely to extend credit to enterprises of medium scale (100-500 employees, up to $5 million in annual sales) than to those of smaller scale (5-100 employees, up to $2 million in annual sales). A definition of medium and smaller scale enterprises based on number of employees is perhaps misleading because these enterprises are more labor intensive than comparable industries in other parts of the world. The PSSP will explore ways to help smaller scale enterprises which may not formally participate in the Project through special studies of their needs for credit and technical assistance. The Project will also encourage the commercial banks to expand their lending to smaller MSEs.

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The medium scale enterprises surveyed by Coopers and Lybrand are mostly industries producing consumer items of primary necessity for local consumption: matches, bricks, paint, wood and metal products, plastic shoes, cloth, batteries, soap and the like. All companies in the medium scale survey are located in Kinshasa, the hub of economic activity in Zaire but many have branches or distributors in other regions. Smaller scale enterprises and trading companies were surveyed in Kinshasa and Lubumbashi and the surrounding regions of Shaba and Bandundu. This analysis will discuss primarily the medium scale enterprises surveyed in Kinshasa as these companies will be the first beneficiaries of the Project.

These companies are primarily owned by expatriates, with some Zairian participation. The expatriate owners and managers tend to be second-generation in Zaire and very dedicated to the country, having persisted in their businesses despite much upheaval in the economic environment. The top two or three executives of the company tend to be expatriates; the rest of the decisionmakers and managers are Zairian.

(2) Need To Support Medium Scale Enterprises

The PSSP is filling a gap in assistance to a crucial sector of the economy. Zaire's economy has been heavily weighted to the commercial as opposed to the manufacturing sector within the private sector as a whole. Banks prefer extending credit to trading enterprises, especially those dealing in diamonds, gold and coffee, over industry because of the rapid turnover of funds. MSEs have been severely handicapped by restricted access to foreign exchange and by other factors in the economic environment such as labor and tax regulations. Larger firms are often subsidiaries of multinational corporations and may have more access to foreign exchange. Two new projects, funded by the World Bank and the Cooperation Francaise, and the government organization OPEZ, are designed to support smaller scale enterprises. Agriculture has also received a large portion of development support and has benefitted from recent price liberalization efforts.

(3) Current Situation

MSEs are experiencing an especially sharp decline in their access to foreign currency through the banking system as commercial banks must now fund fuel imports out of their total reservoir of foreign currency. This expense represents 30-40% of the commercial banks' foreign exchange. Consequently, to meet its needs for imported raw materials and spare parts, a company may have to borrow foreign exchange on the black market at 25-30% higher than the official rate. This situation has forced the companies to raise prices. High inflation has decreased consumers' purchasing power as well so there have been corresponding lags in demand. Plants are now operating at an average of 50% capacity due in part to decreased demand but mostly from scarcity of raw material inputs.

(4) Beneficiaries Of The Local Currency Lending Program

Under the Local Currency Lending Program, companies will have access to credit for purchase of local raw materials, spare parts available from local distributors, and for agricultural campaign credit. With this credit, eligible trading companies can expand their activities. Scarcity of credit is often cited as a major constraint in agricultural marketing because traders must have substantial sums at their disposal at the opening of the campaign. Spare parts for trucks are another important expense for traders. Credit for purchase of local raw materials would allow companies to buy, for example, sugar and palm oil from local agro-industries.

It is hoped that this line of credit will be available to smaller MSEs as the guarantees involved will be less exacting than those for the foreign currency lending program. Through the local currency program, the PSSP hopes to encourage banks to extend credit to new customers with local needs.

4.3 MSEs And Non-Target Beneficiaries

(1) Consumers

Medium and small scale enterprises represent a small percentage of total GDP - 6.17% for the entire manufacturing sector - but they play an important role in the national economy. Under the PSSP and other donor programs, it is expected that this sector's share of the GDP will grow. The companies surveyed produce products of primary necessity for local consumption. Access to foreign currency through the Project will enable these companies to import essential raw materials and spare parts, while local currency loans will provide credit for local raw materials and working capital, thus lowering unit costs of production. This savings can be passed on to the consumer. If these companies were not in business the consumer would very likely have to pay much higher prices for imports. Although the value added factor is normally low, these companies still provide import substitutions which decrease the nation's use of foreign exchange.

(2) Employees

The medium scale industries provide a training ground for mechanics, engineers and factory workers. There are very few other resources for quality technical training in Zaire. MSEs are also a source of stable, long term employment. It is estimated that one worker supports an average of six children, his wife and often several other family members. Employees also receive benefits which are valued as much or more than their actual salary. These include health and retirement benefits, culturally valued expenses such as payments for marriages and funerals, and access to food at below-market prices.

It is not expected that the project will generate significant new employment because these companies tend to be overstaffed, and to keep on skilled workers who have been trained over a long period of time. The project will, however, generate substantially higher productivity per worker. Because of high unemployment rates in Kinshasa, workers try to hold on to their jobs. These companies represent one of the few sources of steady employment. The major alternative to wage labor is petty trade and Kinshasa is already saturated with marginally profitable petty traders.

(3) Subcontractors

The medium scale industries surveyed subcontract work to smaller enterprises such as printshops, wholesale food traders, laundry and transport services. In some cases this is a formal arrangement; for example. a firm might regularly requisition forms from a print shop. In other cases, the arrangement may be more informal; for example, a wholesale food buyer brings a stock of food to the plant for resale to the workers when he or she has made a trip to the interior.

Driving through the industrial sector of Kinshasa, one is struck by the array of secondary activity surrounding the companies: women selling food to workers, barbers giving haircuts, street vendors hawking consumer items, carters and taximen moving goods and people.

(4) Marketing And Distribution Chain

Several MSEs surveyed have branches in the interior or depots for their products. Most companies sell their products through wholesalers. Scarcity of foreign exchange has affected the distribution network. Companies have cut back or eliminated credit to their wholesale clients - even those who sell in the interior. Increased access to credit may help these companies to reestablish credit lines, enabling wholesalers to buy more products, sell to retailers at lower prices, and expand their distribution networks.

(5) Links To Agriculture And Rural Areas

The three private sector baseline surveys described above were carried out in Kinshasa, Shaba and Bandundu. The surveys reemphasize the importance of the Kinshasa region in Zaire's economy, and especially in the manufacturing, construction and services sectors. Over 44% of Zaire's GDP in these sectors originates in the Kinshasa region. Almost 50% of manufacturing GDP originates there. Shaba follows as the second most important region. Many companies in that region are linked to the parastatal, Gecamines.

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Most companies in the medium size range either operate in Kinshasa or have their headquarters there, although they may serve directly or indirectly the national market. The "small" segment private sector companies, on the other hand, have local or at best regional markets. With increased access to credit, those medium scale industries with branch factories and national distribution will be able to expand their activities in the interior.

Some of the companies have direct links with agriculture or buy their raw materials in rural areas. Matches are made from local wood and materials to make bricks come from quarries nearby Kinshasa. One company manufactures fiber sacks for agricultural produce. Two thirds of the jute comes from local small farmers via three trading companies. These trading companies get agricultural campaign credit from the jute manufacturer, who in turn distributes the sacks on consignment in the interior. These trading companies cannot get sufficient credit this year to collect the jute.

In some cases the lack of foreign exchange or its high cost has forced companies to search for alternatives to imports. At a brickmaking company, the bricks are now fired by charcoal made from local wood rather than imported fuel. A cereal plant has installed new equipment (USAID funded) to enable it to use locally grown corn rather than the more expensive imported wheat flour for a locally produced weaning food as well as other food products. However, local supplies are often unreliable and of low quality which is why many companies have come to depend on imports--even of agricultural goods. Thus, shortage of foreign exchange has not necessarily stimulated local supply.

Special studies for the Project will examine ways to strengthen the links between agriculture and industry. See, specifically, Study 4, Survey Opportunities For Encouraging Development of Private Sector Businesses Utilizing Local Sources of Material foı Both Local and Export Markets in Annex 6, Proposed Research, Evaluation and Impact Studies and Human Resource Development. The Mission's overall support of agricultural development, with two large scale area development programs, and PVOs, under the Small Project Support Project, is helping to stimulate the agricultural sector and rural areas in order to better supply local industry. The Mission is involved in the fundamental rebuilding of rural services and infrastructure: roads, health centers, agricultural extension and basic agricultural research. Many MSE managers expressed an interest in buying locally if supplies and quality improve. Some managers continue to buy local products, even if imports are cheaper and more reliable, because they feel that they must do their part to keep up local supply lines and local agriculture. The local currency lending program will be able to aid agriculture directly by providing credit for purchase of local raw materials, spare parts for trucks, and agricultural campaigns. Annex 7, Implementation Procedures For Private Sector Financing, details procedures and mechanisms for this program.

Most importantly, any program to expand the industrial sector, to encourage export industries or links to the agricultural sector, must build on the base of the industrial sector which already exists.

4.4 Credit And Savings In The Informal Sector

(1) Credit Unions

USAID/ARD Zaire commissioned a report on Credit Unions and informal financial institutions in May 1987. Consultant John Gadway describes the credit union (COOPEC) operating in Bandundu Region as a "vigorous, aggressive, low-cost, rural institution that provides meaningful financial services, directly, to tens of thousands of low-income individuals." Despite his enthusiasm for the credit unions, Gadway goes on to point out that these institutions are fragile and in need of technical assistance. He cautions against using the credit unions to distribute foreign credit, noting that "there appears to be very little demand for credit on the part of small holders in the rural areas of Zaire."

There is, however, a significant demand for credit on the part of rural entrepreneurs for trucks and agricultural campaigns but "meeting this demand is probably not possible without the prior development of viable local financial institutions, and therefore must be considered a long range goal."

(2) Implications For The PSSP

The lessons from the Gadway report are twofold: 1) These institutions need, above all, technical assistance, not an influx of foreign credit. The transition from a savings to a savings and credit institution is slow and requires careful management. 2) Any assistance from the PSSP must be coordinated with other donors' assistance and with USAID area development programs in Bandundu and Shaba. The goal would be to forge links between agricultural production and marketing and MSEs in urban areas.

The credit unions operate in the urban areas as well, servicing small businesses. Many of these institutions are linked to PVOs such as church groups. Thus any assistance should be coordinated with USAID's PVO Support Project which is currently being designed. Independent discussions with a consulting company which audited credit unions in Kinshasa reveal that urban as well as rural credit unions are in need of a great deal of technical assistance.

The PSSP will fund special studies on how credit unions and informal financial institutions mobilize domestic savings and provide credit to MSEs. See Study 3, Survey Informal Sector Savings and Credit Activities.

(3) Informal Credit And Savings Institutions

Buying foreign exchange on the parallel market costs approximately 30% more than the official rate. Much of this foreign exchange comes from traders in diamonds, gold and coffee who sell overseas and also need local currency to buy their commodities.

Local currency is available from "loan sharks" who charge up to 50% interest on short term - one month - loans. Accountants or cashiers in a company may provide credit on these terms to other workers.

Small traders can get supplies from wholesalers on credit if they are very good customers, just as larger companies may receive foreign suppliers' credit or credit from a parent company. The sack company mentioned above gives credit to traders to buy jute and also distributes the sacks to wholesalers in the interior on consignment.

Family funds and self-financing are important sources of funding for many MSEs, especially the smaller ones. Owners may keep a bank account in Europe and draw on these funds. One enterprise may invest in creating a new company. For example, a trading group may create small manufacturing companies and distribute their products.

Tontines or Likelemba are informal savings groups found in many different settings: on the job, in church, alumni or professional organizations. Some of these groups are rotating credit associations which give each member a lump sum on a rotating basis, depending on the total number of members in the group. No attempt is made to invest the money collected. Some savings groups collect money to provide for emergency expenses: illness, death, birth, marriage of a member. Money is disbursed by decision of the membership. Other groups buy food wholesale to distribute to their members. Many employee groups perform this function.

(4) Research On Smaller Enterprises' Access To Credit

MSEs with fewer than 100 workers and less than $2 million in annual sales have very restricted access to foreign exchange. They have to obtain it on the black market at much higher than the official rate. Credit unions and informal institutions provide savings mechanisms but offer very little credit. SOFIDE, the development bank, has provided medium term credit for MSEs but this credit has proved to be extremely costly since the foreign exchange risk is borne by the borrower.

A new institution, funded by the World Bank, Bureau d'Encouragement au Developpement des Petites Entreprises (BEDEPE), has been set up to provide credit to MSEs. The exchange risks will be absorbed by the GOZ and dossiers will be processed at a much faster rate than was the case with SOFIDE. BEDEPE also gives seminars for business people to help them prepare dossiers for the bank.

Since BEDEPE is a new institution, it will be necessary to track its successes and failures in lending to MSEs. The PSSP will observe the evolution of BEDEPE and the Credit Unions to determine how best to help smaller enterprises meet their credit needs. Future projects growing out of this research may help to meet these needs.

## 4.5 Women's Participation In The Private Sector

### (1) Patterns Of Participation In MSEs

Women are underrepresented both as owners and workers in the MSEs surveyed for the project. There was only one women owner in the medium sized company survey and the average percentage of women employees was under 4%. Women in general do not have a high rate of participation in the formal private sector in Zaire, but are very active in business in the informal sector.

There are major barriers to women entering the formal private sector, especially industry. A married woman must have her husband's permission to open a bank account or to work. She may be fired from her job if her husband no longer wants her to work. She is prohibited by traditional law from directly inheriting businesses or property.

National law allows women four months maternity leave at two-thirds pay, and women also get four extra days off each month. The birthrate is very high in Zaire and infants and children often fall ill. Childcare is exclusively the mother's responsibility and represents a large portion of her daily activities. If both parents are working, it is almost always the mother who will take time off from her job to care for an ailing child.

For these reasons, owners and managers of MSEs often prefer not to hire women. Nevertheless, a few reported that women are more productive than men on the job. One larger company which was contacted separately from the Coopers and Lybrand survey reported that they have set up a candy factory in the interior with 50 women as employees and they are very satisfied with the results. Any Kinshasa based company which seriously wanted to hire women would have to consider on-site daycare. At this time, MSEs are in no financial position to incur such an additional expense.

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A study proposed under the PSSP will examine women's participation in the formal private sector. Funded in local currency, the study will use a local women in development group to examine barriers to and possibilities for women workers and business owners, including women's level of productivity and policy issues which hinder the hiring of women and women's access to banking services.

(2) Women In The Informal Sector

A woman's business activities often complement those of her husband's. The husband may, through his job, have contacts which the wife will exploit in her business, such as buying and selling cloth or manioc products. For example, one company manager interviewed had invested in a vegetable garden business for his wife outside of Kinshasa and reported that she is very successful. Husbands may also bestow real property on their wives, from which they earn income. Thus there is a high percentage of women restaurant owners and proprietors of rental housing. A woman may actually be "managing" the property for her sons but she keeps the income as long as she lives.

A preliminary study for the World Bank on "the unrecorded economy" describes how women engaging in trade and informal service activities fill the gap in family income between the husband's official salary and the family's consumption needs. The wife's contribution may be substantially larger than the husband's.

Market women are responsible for the supply of most fresh produce in the cities. Some women rent or even own trucks. In the Bandundu area, Kinshasa-based women traders have commissioned the building of large motorized boats for river transport.

Efforts to integrate women into the formal sector have often been unsuccessful for the following reasons:

- o Women's groups and cooperatives which might provide assistance to women workers or through which a project might assist women are fragile and of short duration.
- o Women's work in the informal sector avoids the visibility to taxation and licensing that registered companies and salaried work engenders. Companies in Zaire are burdened with an overwhelming array of taxes and workers as well must pay a high percentage of their wages in taxes.
- o Women's childcare responsibilities make it difficult for them to keep the regular hours required for industrial work.

- o Very few women enter technical institutes or receive technical training. Women's jobs are mostly secretarial or related to their traditional activities such as cleaning, cooking or packing products.

- o Unemployment rates are very high and priority for jobs goes to men in the household.

(3) Opportunities For Women In The Private Sector

Despite the obstacles mentioned above, a few women are working in MSEs, mostly as secretaries, but some on the shop floor. BEDEPE plans to have special training seminars for women entrepreneurs. Some training for businesswomen has been provided through AFECOZA, the woman traders' association, and this will continue under Cooperation Francaise's technical assistance program to ANEZA.

USAID and other donors have provided some women the opportunity to study management abroad, either in Europe, the United States or other countries in Africa. The PSSP will search out qualified women in the banking and management sectors for training through USAID's AFGRAD and HRDA programs. HRDA already sets a target of 33% female participation in the program.

USAID is working to implement an effective family planning effort in Zaire so that women can space the births of their children. This effort helps women to enter into the workforce if they desire to do so.

The social stigma attached to being a single working woman is gradually being relaxed, at least in the urban environment. In addition many men are beginning to appreciate a wife who works in the formal sector as she may be better educated and have access to a regular salary. Nevertheless, women's work and responsibilities are often issues of struggle in a household, especially where men do not feel secure about their own jobs and incomes. Thus, improving the overall economic climate will contribute to the security necessary to contemplate changes in gender roles. The study proposed above of women's participation in the formal sector will enable the project to assess how best to assist working women and women in business.

4.6 Representative Case Studies

All MSEs surveyed by Coopers and Lybrand are in the industrial/manufacturing sector (with the exception of two trading groups) and are located in Kinshasa. They are a diverse group. Follow-up interviews were conducted with top managers in six companies in the Coopers and Lybrand survey, focusing specifically on relations with

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the wider community: consumers, suppliers, distributors, subcontractors and employees. Investment plans, operation and management problems, and the overall economic situation were also discussed. These companies represent important segments of the manufacturing sector: construction, foods, consumer goods and agricultural supplies. Though their raw material and spare parts needs are quite divergent, they face many common operating problems. See Annex 2, The Technical Analysis, for a general discussion of the companies surveyed.

(1) BRIKIN

- Manufacturers of bricks and tiles from local materials
- Credit needs: $430,000; Z 17,235,000 (Z 12,500,000 available)
- In business since 1949. 296 employees, Z 73,184,000 sales in 1987.
- Contact: M. Mathy, Director

M. Mathy pointed out that the value added factor by his company is very high, as all raw materials come from quarries in Bas-Zaire, outside of Kinshasa. In addition, he has designed furnaces which use locally-produced charcoal to fire the bricks. M. Mathy is Belgian, born in Zaire. He is past president of the Rotary International for Central Africa, and recipient of the GOZ's Presidential "Ordre du Leopard." All workers are trained at the factory and many have been with the company for twenty years. BRIKIN is the only brick making company currently operating in Kinshasa. They export bricks to the Congo and Central African Republic. BRIKIN sells directly to the customer, whether it be a large firm or an individual.

(2) VAP (Victoria Assorted Products)

- Manufactures baby food, biscuits and chewing gum
- Credit needs: $788,500; ($342,800 available). Z 110,000,000 (Z 50,000,000 available).
- In business since 1955. 297 employees. Z 374,426,000 sales in 1987.
- Contact: Cit. Ntumba Kalonji, Financial Director.

VAP recently received a loan from USAID to install a new processing machine for its baby food cereal line. This machine will enable the company to use up to 70 percent of locally produced corn instead of imported wheat flour. They need credit to purchase packaging materials for the new product. Cit. Ntumba noted that each time there is a price rise in their products due to increased cost of raw materials, there is a corresponding drop in demand. With the new processing facility on-line, VAP expects to cut unit costs and lower prices to the consumer. They distribute their products in the interior and target their baby cereal line to the critical weaning age, when infants are extremely vulnerable to disease and malnutrition. VAP has an agreement to buy corn from an PVO based in the Equator Region run by Catholic priests which is also receiving USAID support.

(3) TREFILKIN

- o Manufacturers wire mesh, fencing and nails
- o Credit needs: $1,725,000 ($400,000 available) for imported material. $150,000 spare parts, Z 12,000,000 for local spare parts. New project: galvanized tin roofs: $250,000.
- o In business since 1963. 160 employees. Z 265,150,000 sales in 1987.
- o Contact: M. Dernelle, General Manager

TREFILKIN has recently ordered machines to fabricate galvanized tin roofing and needs credit to finance imports of raw materials. They are the only company in Kinshasa with the heavy equipment necessary to produce quality nails and wire mesh. M. Dernelle was raised in Zaire and educated in Belgium and the United States. Three women are employed on the shop floor. The foreman mentioned that these women were more productive than the men. Employee benefits include a dispensary, medicine and access to food at below-cost price. There are twenty workers in the company who have been with the company for over twenty years. All workers receive intensive on-the-job training. TREFILKIN sells fencing to plantations in the interior and provides sixty-day credit, though this financing is becoming more difficult.

The company weathered nationalization (Zairianization) in 1973 by becoming part of IPS, a company with small metalworks throughout Africa, which has 34 percent GOZ participation.

(4) MAZAL

- o Manufacturers matches
- o Credit needs: $160,000. $13,500 spare parts, raw materials $80,000/month
- o In business since 1971. 234 employees. Z 356,360,000 sales in 1987.

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o Contact: M. Migliorini, General Manager

MAZAL is a wholly-owned subsidiary of Swedish Match. The company purchases local wood but the rest of the materials are imported. They seek financing to begin manufacturing match boxes at the factory, which currently represents their largest outlay for raw materials. M. Migliorini was born in Zaire and educated in Belgium. He has sent employees for English language training. Three of the company's major wholesale clients are women. Recently, the company was forced to discontinue distributor credit. The marketing chain extends to street vendors who sell by the box. Wholesalers gross about 400Z per carton (1,000 boxes); retailers about 1.5Z per box (100Z = 50 cents). MAZAL has organized a workers' savings association or Tontine which purchases food on credit, guaranteed by the company.

MAZAL borrowed Z 17,000,000 from SOFIDE, the development bank, for which they have borne the exchange risk. This loan is being repaid despite the 300 percent devaluation of the Zaire.

(5) PENAZA

- o Manufacturers paints and varnishes.
- o Credit needs: $1,714.200 ($428,500 available).
- o In business since 1961. 271 employees in 4 locations (Kinshasa, Kisangani, Likasi and Lubumbashi). Z 378,965,000 sales in 1987.
- o Contact: M. Pol Snitz, General Manager

PENAZA is wholly owned by a Zairian woman who took over ownership from two Belgians after Zairanization. The company is managed by M. Snitz, who has lived in Zaire for thirty years and has been with the company since its foundation. It is the only paint factory in Africa which collaborates with DuPont, and the only factory in Zaire with research facilities. The research facility has trained several people who have gone on to start other companies. Since there has recently been a dramatic rise in competition, PENAZA has decided to specialize in quality products for specific uses. They supplied paint to General Motors when it was in Zaire which represented a large portion of their market.

PENAZA has three smaller factories in Kisangani, Likasi and Lubumbashi, and distributes its products through hardware stores. They have recently cut distributor credit from 90 days to 30 days.

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PENAZA buys local soy oil, copal and cement. The soy oil is produced by an PVO-supported agricultural cooperative. Though only a small part of their raw material needs, M. Snitz feels it important to keep up local supply lines.

(6) TISSAKIN

- o Manufactures jute sacks
- o Credit needs: \$3,070,000 (\$1,543,000 available); Z 380,366,000 Z 205,366,000 available)
- o In business since 1948. 598 Employees. Z 482,260,922 sales in 1987
- o Contact: M. Husain, General Manager

TISSAKIN has extensive links with the agricultural sector, specifically small jute farmers in Bandundu Region and traders buying the jute. The company also imports high quality jute from Bangladesh (1/4 of total jute) and has participated in the CIP to import this jute. Mr. Husain, a long time resident of Zaire, described how jute farming in Zaire - once a major agro-industry - experiences severe setbacks when credit is not available for the agricultural campaign. The villagers will not gather any more jute unless the first jute harvest is bought. If not harvested, the jute dries up and is useless. The credit squeeze has gotten more severe in the last two years, and this year is very tight. TISSAKIN provides credit to the traders but the company's credit resources are limited. They compete with imported sacks from Bangladesh which are dumped on the market. The company helped to finance a roads project in Bandundu Region with USAID, working through a local PVO. TISSAKIN is 60% Belgian and 40% Zairian owned.

## 4.7 Implications For Further Research

### (1) Assessing Spread Effects

The target beneficiary population for the foreign exchange import and the local currency lending elements of the program consists primarily of medium sized private sector businesses already in production. Spread effects from assistance to these companies are suggested above. The project will monitor these spread effects, and will collect gender-disaggregated data in monitoring the impact of the Project on participating MSEs. See suggested survey below. The depth and breadth of Project spread effects depend a great deal on developments in the wider economy, effective coordination with other projects within the Mission and with other donors. Exhibit 4.1 illustrates the best case scenario for spread effects from the PSSP.

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The PSSP has built in and budgeted for an on-going research program which will systematically investigate other project and program possibilities for addressing the important micro-sector and women in development issues. Research into the encouragement of the growth of businesses using local raw material inputs will also be conducted. For further details on the PSSP research program, refer to Annex 6, Proposed Research, Evaluation and Impact Studies and Human Resources Development.

(2) Survey Plan For MSEs

The study suggested below is to be carried out at baseline and annually thereafter to determine project impact on MSEs. All MSEs participating in the PSSP will be surveyed. This sample does not include detailed financial information which will be collected. Refer to Study 1, Annex 6.

I. Ownership, Partners and Shareholders
  A. Percent Expatriate
  B. Percent Zairian
  C. Percent Women (of A and B)

II. Personnel
  A. Number of Salaried Workers
    1. Management
    2. Workers
    3. Percent Women (of 1 and 2)
  B. Base Salaries (Amount and Percent of Total Expenses)
    1. Management
    2. Worker
  C. Benefits (Dollar Value of Each Benefit Provided and Percent of Total Expenses)
    1. Management
  2. Worker
  D. Training Opportunities
    1. Dollar Value and Percent of Total Expenses
    2. Number of Women Trained

III. Use of Smaller Enterprises
  A. Number and Type of Subcontractor
  B. Amount Spent per Month on Subcontractors and Percent of Total Costs.
  C. Percent of Women Subcontractors

IV. Sources of Raw Materials (Amount and Percent of Total Raw Materials Used
  A. Imports
  B. Local - Wholesaler Imports
  C. Local Product
  1. Source of Product
  2. Type of Product
  3. Supplier of Product (e.g. Trader, PVO, Cooperative)

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V. Marketing and Distribution
   A. Production Units Outside Kinshasa
   B. Amount and Percent of Total Sales through Wholesalers (Percent Women Wholesalers)
   C. Amount and Percent of Total Sales Directly to Client
   D. Market Outlets by Region or Urban Zone
      1. Number of Depots
      2. Number of Stores
      3. Number of Small Scale Traders Carrying Product

VI. Sources of Credit (Amount and Percent of Total Credit)
   A. Own or Family Funds
   B. Commercial Banks (through PSSP)
   C. Commercial Banks (Other)
   D. SOFIDE, BEDEPE
   E. Overdraft
   F. Informal Market

VII. Uses of Credit
   A. Foreign Exchange
      1. Raw Materials Imported (Type, Amount and Percent of Total Expenses)
      2. Capital Investments (Type, Amount and Percent of Total Expenses)
   B. Local Currency (Uses, Amount and Percent of Total Expenses)

VIII. Price of Product
   A. Wholesale
   B. Retail
   C. Production Cost per Unit
   D. Price of Competing Products (Including Imports)
   E. Prices of Basic Consumer Items in Local Market (e.g tomato paste, bread, cooking oil, salt, sugar and cloth) to assess Cost of Living

IX. Free Questions
   A. How do you learn about new investment opportunities?
   B. Are you experiencing difficulties with bank credit?
   C. What are your major operating problems?
   D. Would you consider hiring qualified women graduates of a technical school or management program, if their qualifications were equal or superior to other applicants? Why or why not?
   E. How do you view the overall economic climate as compared to last year?
   F. What about future problems and possibilities?
   G. Is your product changing in response to consumer demand? Why, and in what way?

EXHIBIT 4.1

BEST CASE SCENARIO

| CASE | RESULTS | SECTOR BENEFITTING |
|---|---|---|
| MSE gets foreign exchange credit | → 1. Imports needed spare parts and machinery<br><br>- Increased plant capacity<br>- Increased worker productivity<br><br>→ 2. Imports raw materials<br><br>- Unit price of product falls | → WORKERS<br><br>- Increased salaries, benefits and training opportunities<br><br>→ CONSUMERS<br><br>- Prices fall<br>- Distribution widens |
| MSE gets local currency credit | → 1. Buys local raw materials<br><br>- Credit for agricultural campaigns<br><br>→ 2. Gets working capital<br><br>- Becomes more efficient | → AGRICULTURE/RURAL AREAS<br><br>- Local agro-industry grows<br><br>- Farmgate prices rise<br><br>→ DISTRIBUTORS/ SUBCONTRACTORS<br><br>- Reestablish/extend distributor credit<br><br>- Increased use of subcontractors |
| MSEs interact with other USAID Projs. | → 1. Buys from USAID-supported PVO agricultural cooperative<br><br>→ 2. Buys in Project area | → MSEs<br>LOCAL PRODUCERS<br><br>- Higher farmer productivity and better quality crops from from research and extension<br><br>- Better access to rural areas, improved roads |

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ANNEX 5

# THE ADMINISTRATIVE ANALYSIS

- PRIVATE SECTOR SUPPORT PROGRAM -

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## ANNEX 5 ADMINISTRATIVE ANALYSIS

### 5.1 Purpose Of Administrative Annex

This Administrative Annex has three basic purposes:

- o Define the operational, administrative and management information and control requirements for successfully meeting program goals.
- o Recommend a least cost organization, staffing and systems structure which will meet project administrative requirements.
- o Assess the capabilities of implementing organizations to meet project and management objectives: organization, human resources, finance and management control systems.

Annex 5 also describes detailed systems design activities which will follow PAAD approval.

### 5.2 Project Overview And Operational And Control Requirements

The Private Sector Support Program is an integrated project of financial sector reform and direct assistance to medium and smaller-scale enterprises (MSEs). The PSSP has been designed to achieve two important objectives:

- o Restructure the zairian commercial banking sector and enable it to support productive investment by medium and smaller-scale enterprises.
- o By assisting MSEs, help (1) reverse the decline in industrial production and (2) re-establish demand and supply linkages between urban and rural areas.

Four primary organizational entities are directly involved in the planning, management and evaluation of the PSSP.

(1) USAID which has overall responsibility for ensuring that approved project objectives are met; all appropriate regulatory and administrative controls are designed, installed and complied with; participants and beneficiaries meet all program requirements and contractual commitments; and continuing assessments of performance and evaluations of results are made and reported.

(2) The Government Of Zaire (GOZ) is the official entity with whom all project agreements are negotiated and concluded. The GOZ has the primary responsibility for ensuring that its commitments under the PSSP are met, in particular agreed covenants, conditionalities and benchmarks established as conditions for the grant.

(3) Participating Commercial And Fiduciary Banks which act as intermediary financial institutions in administering foreign exchange allocations and loans to qualified private sector target borrowers, or which act as fiduciary institutions on behalf of USAID in carrying out contracted supervision, control and reporting of Counterpart Fund accounts.

(4) Private Sector Medium And Small Sized Borrowers who are pre-qualified by participating commercial bank lenders in terms of financial credibility and ability to qualify under specific PSSP commodity import and loan conditions.

Refer to Exhibit 5.1 of this Annex, Basic Program Objectives and Participating Organizations which illustrates the relationships among these participating organizations.

The sections which follow describe the management and staffing structures and the management information, control and reporting systems which have been designed to ensure that these four major participating groups interact appropriately and effectively and fully meet program objectives, operating policies and procedure, and contractual commitments.

5.3. Proposed Program Structure, Responsibilities, Authorities And Working Relationships

USAID Zaire has established several basic principles to guide the management of the PSSP.

- Senior USAID Management will directly concern itself with continuing high level discussions and policy dialogue with the GOZ and donor agencies.

- Participating Commercial Banks will be responsible for qualifying borrowers, extending credit, opening letters of credit, accounting for and collecting loans, and assuming credit risks vis a vis private sector MSE borrowers.

- A PSSP Program Management Unit comprised of USAID's trained CIP staff and several PSC specialists will carry out day-to-day project responsibilities; supervise, coordinate and evaluate the work of the fiduciary bank, consulting and auditing groups; make periodic and special reports of progress against plan; and recommend changes in program content, scope, or management.

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EXHIBIT 5.1

BASIC PROGRAM OBJECTIVES AND PARTICIPATION ORGANIZATIONS

- PRIVATE SECTOR SUPPORT PROGRAM -

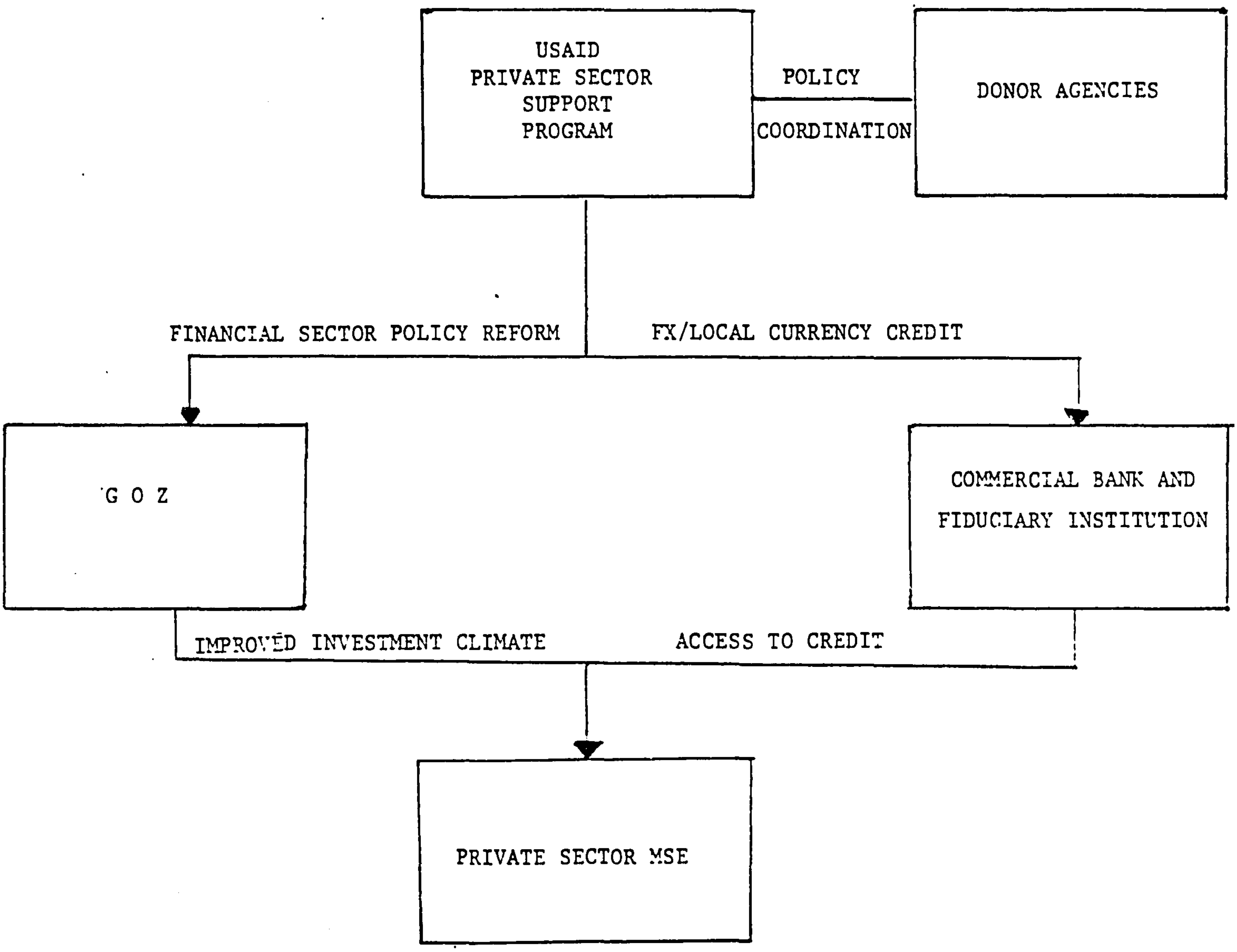


Exhibit 5.2, Program Structure and Relationships, illustrates these relationships. The sections which follow summarize the roles of the principal participants in the PSSP's on-going management process.

(1) USAID Zaire

USAID policy discussions with GOZ and donor agencies will continue to be directly managed by the Mission's senior executives. Responsibility for overall project implementation will rest with the Project Design and Operations Office (PDO), which also has responsibility for current CIP projects. The Mission's Program Economist will work closely with PDO in monitoring the financial sector reform elements of the project.

A Program Management Unit comprised of a Program Manager, Program Economist, Financial Sector Economist and Commodity Import Manager will be created to carry out the on-going implementation, operational, and evaluation workloads which are associated with such a project. There are a number of considerations justifying the need for such a project management capability:

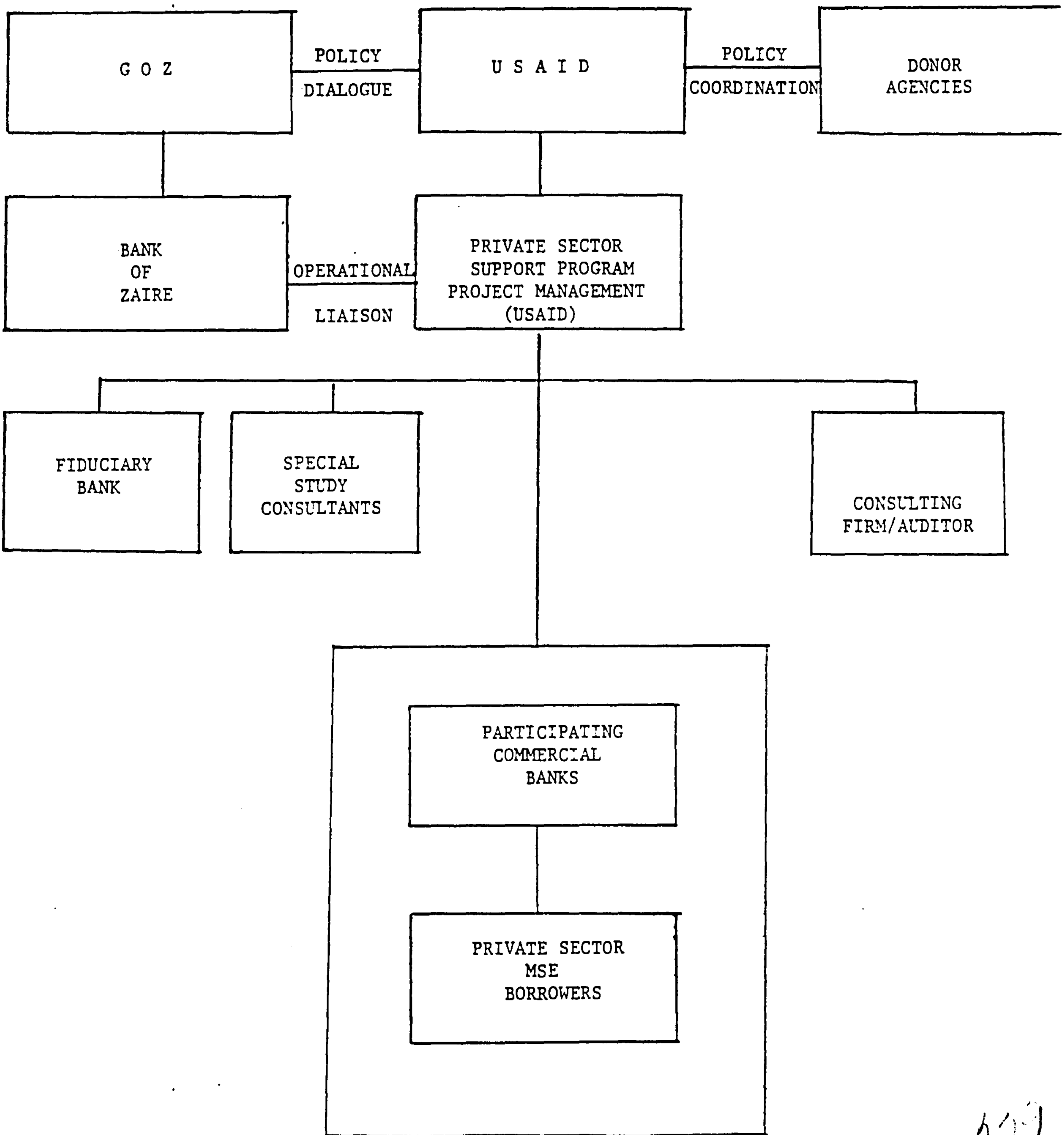
- The Mission's current workloads apart from the PSSP.
- The size and importance of the PSSP which is the centerpiece of the Mission's private sector strategy.
- The need for careful monitoring of GOZ performance in undertaking agreed regulatory reforms, and for carrying out studies measuring the impact of these reforms.
- An existing trained CIP staff with well established connections with the Bank of Zaire, commercial banks, private sector MSEs. This existing group has the capability to achieve rapid start up and ensure that commodity imports and financing procedures comply with AID Regulation 1.
- The need to manage the contractors charged with implementing the foreign exchange, lending, policy surveys, and monitoring activities.

Exhibit 5.3, Program Management Structure, summarizes the staffing of the Program Management Unit (PMU) and the major responsibilities of the fiduciary bank, local consulting-audit firm, and special consultants. Position descriptions and qualifications for each of the four positions proposed for the PSSP Management Unit are also included.

EXHIBIT 5.2

PROGRAM STRUCTURE AND RELATIONSHIPS

- PRIVATE SECTOR SUPPORT PROGRAM -

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(2) Fiduciary Bank

USAID currently is working with a private commercial bank as fiduciary for the Counterpart Funds generated by CIPs and PL480 private commercial import programs. Counterpart Fund contributions are made directly by importers' banks to the bank holding the core Counterpart Fund account (currently Citibank/Zaire). Several contributions, spread out over many months in some cases, are made for each import transaction. USAID is now phasing in a program of charging importers interest on payments terms, which will be added to Counterpart Fund contributions. The Mission is also pursuing maximum interest earnings on any balances remaining in Counterpart Fund accounts. Thus, bank management of Counterpart Fund accounts is satisfactory and is becoming increasingly sophisticated.

The tasks of the Fiduciary Bank under the Private Sector Support Program will build on and expand those already performed by the banks holding the Counterpart Funds, including more detailed reporting of all CPF, collections of payments and domiciling of bank guarantees. Commercial banks in Zaire have been examined regarding the tasks of the fiduciary bank as discussed above, and there appear to be potential candidates who are both capable and interested in this role.

(3) Consulting Firm and Auditor

A key to the impact of the program in the medium to long term will be the continuing development of information about the financial and MSE sectors. This will be accomplished throughout the program by the use of a private management consultant or auditing firm. The consultant will identify achievements, progress, shortcomings, and problems in both these sectors relating potentially to their particular institutional characteristics, the macroeconomic environment, or the governmental regulatory environment.

To achieve the insight into local business institutions, the Mission requires the availability of a management consultant or auditing firm that combines the characteristics of working to international quality standards and of intimate knowledge of the environment, language, and practice of business in Zaire today.

Several such firms exist in Zaire - two American and one Belgian - among them at least three affiliates of international accounting firms and one or more Zairian firms. Three of these firms have worked under contract for USAID in various capacities, two in the preparation of USAID's private sector activities.

(4) Special Study Consultants

Provision will be made for the use of consultants retained for short term consulting assignments requiring specialized expertise. These consulting studies will include specific and general impact surveys, informal private sector lending mechanisms,

EXHIBIT 5.3

PROGRAM MANAGEMENT STRUCTURE

- PRIVATE SECTOR SUPPORT PROGRAM -

**USAID**

DIVISION CHIEF
PDO

**PRIVATE SECTOR SUPPORT PROGRAM MANAGEMENT UNIT (USAID)**

- PROGRAM MANAGER
- FINANCIAL SECTOR ECONOMIST (GOZ)
- PROGRAM ECONOMIST
- CIP UNIT

**FIDUCIARY BANK**

- SUPERVISE DOLLAR AND LOCAL CURRENCY DISBURSEMENTS
- CONTROL LOCAL CURRENCY PAYMENTS TO COUNTERPART FUND
- DOMICILE BANK GUARANTIES FOR LOCAL CURRENCY PAYMENTS
- PROVIDE DETAILED MONITORING REPORTS ON CPF ACCOUNTS

**SPECIAL STUDY CONSULTANTS**

- CONDUCT SPECIALIZED SURVEYS, EVALUATIONS AND IMPACT STUDIES
- PROVIDE SPECIALIAZED CONSULTANTS FOR SOCIAL-CULTURAL ANALYSES, IN PARTICULAR WOMEN IN DEVELOPMENT, INFORMAL LENDING AND MICRO BORROWER SEGMENT

**CONSULTING FIRM AND AUDITOR**

- MONITOR ACHIEVEMENTS, PROGRESS, AND PROBLEMS OF COMMERCIAL BANK LENDING TO SMEs
- CONDUCT SURVEYS ON BORROWERS CAPACITY UTILIZATION
- AUDIT COMMERCIAL AND FIDUCIARY BANK LENDING, ACCOUNTING AND REPORTING ACTIVITIES

micro segment lending research, socio-cultural benefits analyses, and women in development issues and impacts. The PSSP Program Manager will be responsible for the development of appropriate work scope statements and budget estimates, and for the direct supervision and coordination of the consultant's work.

(5) Participating Commercial Banks

Zaire has an efficient and profitable banking system which, despite GOZ shareholding in some banks, operates under private management. Foreign control of banks is not felt in day-to-day management, although some of the smaller banks are essentially affiliates of multinational banks (e.g., Citibank Zaire).

Banks are free to develop their own services and portfolios within overall credit ceilings, although a quota for credit to the agricultural sector, broadly defined, has been imposed recently. There is no official control on interest rates or fees, and the GOZ does not impose clients on banks.

The Mission has held discussions (with eight commercial banks in Zaire) regarding the proposed project. All the banks contacted expressed substantial interest in participating in the project. The aspects of the program which banks found attractive were the following:

- Availability of foreign exchange and fees from opening L/Cs.
- Possibility of allowing importers to import goods from countries other than to the U.S.
- Absence of exchange risks either for the borrower or the bank.
- Exclusion of PSSP local currency lending from credit ceilings.
- Management of the funding program within the commercial banking system and not through the Central Bank.

Banks are willing to take full credit risks as long as they are allowed to select their own customers and utilize their own credit guidelines. They are prepared, however, to work with companies which fall within the MSE guidelines established by USAID.

Banks have also been encouraged by the Bank of Zaire's decisions to eliminate the requirement for case-by-case Bank of Zaire approval of agricultural loans and medium or long term loans; and to deregulate interest ceilings and allow the banks to charge market rates.

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In conclusion, the Zairian banking sector is institutionally fully capable of fulfilling the role of lending institutions under this project. The challenge facing the project is to contribute to macro-economic, regulatory, and institutional changes that will permit the banking sector to intermediate more domestic financial resources for the benefit of the Zairian private sector at the end of the project.

5.4 The Role Of Financial Intermediaries In The Private Sector Support Program

This section reviews the role of the financial intermediaries - commercial banks and contracted fiduciary institution - in the PSSP.

(1) Foreign Exchange Transactions

Local commercial banks participating in the PSSP will offer letter of credit facilities to eligible private sector importers using the same mechanism employed in AID's existing Commodity Import Programs. Commodities will be financed according to AID Regulation 1. Disbursements to foreign suppliers and repayment to the foreign disbursing bank will employ the normal U.S. Letters of Commitment and commercial bank documentary letters of credit.

The PSSP will also provide local currency loans to importers by offering short to medium repayment terms. The importer's local bank will guarantee such loans, set lending terms and conditions, assume credit risks, be responsible for collections of principal and interest, and make all remittances to the Counterpart Fund under agreement with USAID via a local fiduciary bank.

No local currency will be advanced, however, by the Counterpart Fund or by the bank for imports. Through this mechanism dollars will be utilized to cover foreign exchange requirements and local currencies will be advanced to the borrowers only to cover associated local costs or to allow purchase of locally available raw materials, spare parts, and equipment.

The program will place no constraints on lending conditions between the bank and the borrower as to the collateral, fees, or repayment terms. Since the letter of credit transaction is fully funded by an inflow of foreign exchange provided under terms of the project agreement, the central bank has agreed that the overall lending ceiling and the individual ceiling for the participating bank will not be affected. In any case, IMF has agreed to take the PSSP lending program into account when establishing the new credit ceilings for Zaire. Repayments will be independent of the foreign exchange rate, so that the bank and the borrower will bear no foreign exchange risk.

(2) Approval And Disbursement Mechanisms

Exhibit 5.4 which follows, Document and Finance Flows, illustrates the roles of the local commercial banks and the U.S. disbursing bank in opening, confirming and advising letters of credit and in paying suppliers; and of the local commercial and fiduciary bank in controlling CPF repayments. Exhibit 5.5 Commodity Imports - Documents Flows, portrays the foreign exchange import approval and currency flow process.

Exhibit 5.6, Local Currency Credit and Payment Flows, illustrates the local currency lending process. See Annex 7, Implementation Procedures for Private Sector Financing.

5.5 The Role Of The Fiduciary Bank

(1) Responsibilities

Under the CIP approach, the Fiduciary Bank has the following responsibilities:

- Monitor and collect from participating banks the counterpart fund and interest payments due under different letter of credit and Direct Letters of Commitment issued by USAID.
- Issue monthly reports clearly detailing, per bank and per sector of activities, all outstanding L/Cs and DL/COMs, aging of the past due payments and related interest, and commodities/products being financed.
- Receive letter of credit transaction documents from the participating banks and information as to USAID issued DL/COMs (without the identification of the borrower) setting forth the details, the pertinent transaction number and borrowers account number.
- Receive all payments of principal and interest to the counterpart fund account from participating banks.
- Recommend to USAID and to the GOZ Department of Plan jointly when it is indicated that the guarantee of a participating bank should be called in to cover the failure of an importer to repay the CPF.

(2) Under the local currency lending program, the Fiduciary Bank has the following responsibilities:

- Transfer CPF local currency to the participating bank within one working day of receipt of the request to cover approved loans.

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- o Monitor the counterpart fund payments due under local currency lending.

- o Receive transaction documents from the participating banks (without the identification of the borrower) setting forth the details of the loans, guarantees of promissory notes, and pertinent transaction numbers.

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*Not including the grace period.

EXHIBIT 5.4

DOCUMENT AND FINANCE FLOWS

- PRIVATE SECTOR SUPPORT PROGRAM -

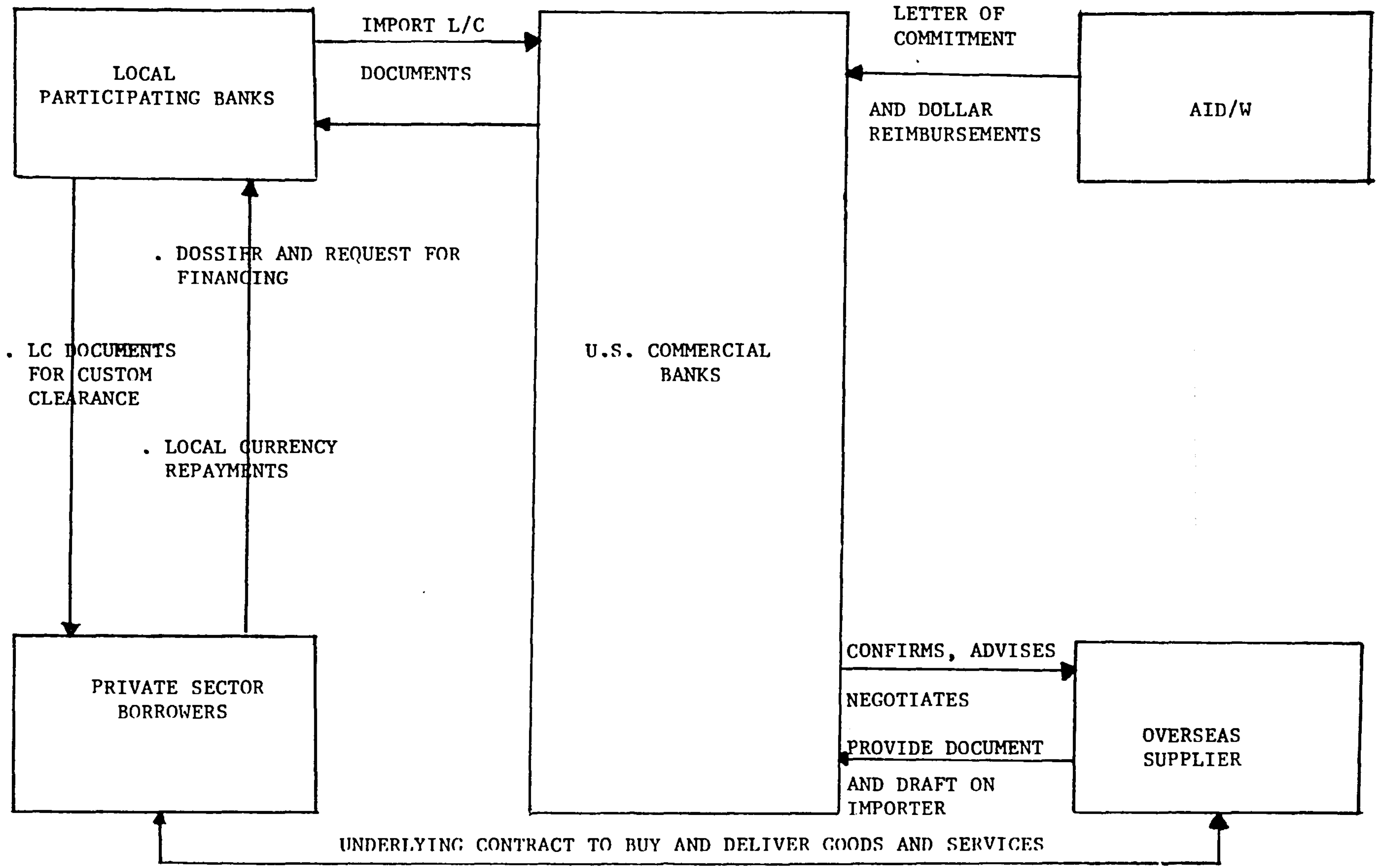

EXHIBIT 5.5

COMMODITY IMPORTS - DOCUMENTS FLOWS

- PRIVATE SECTOR SUPPORT PROGRAM -

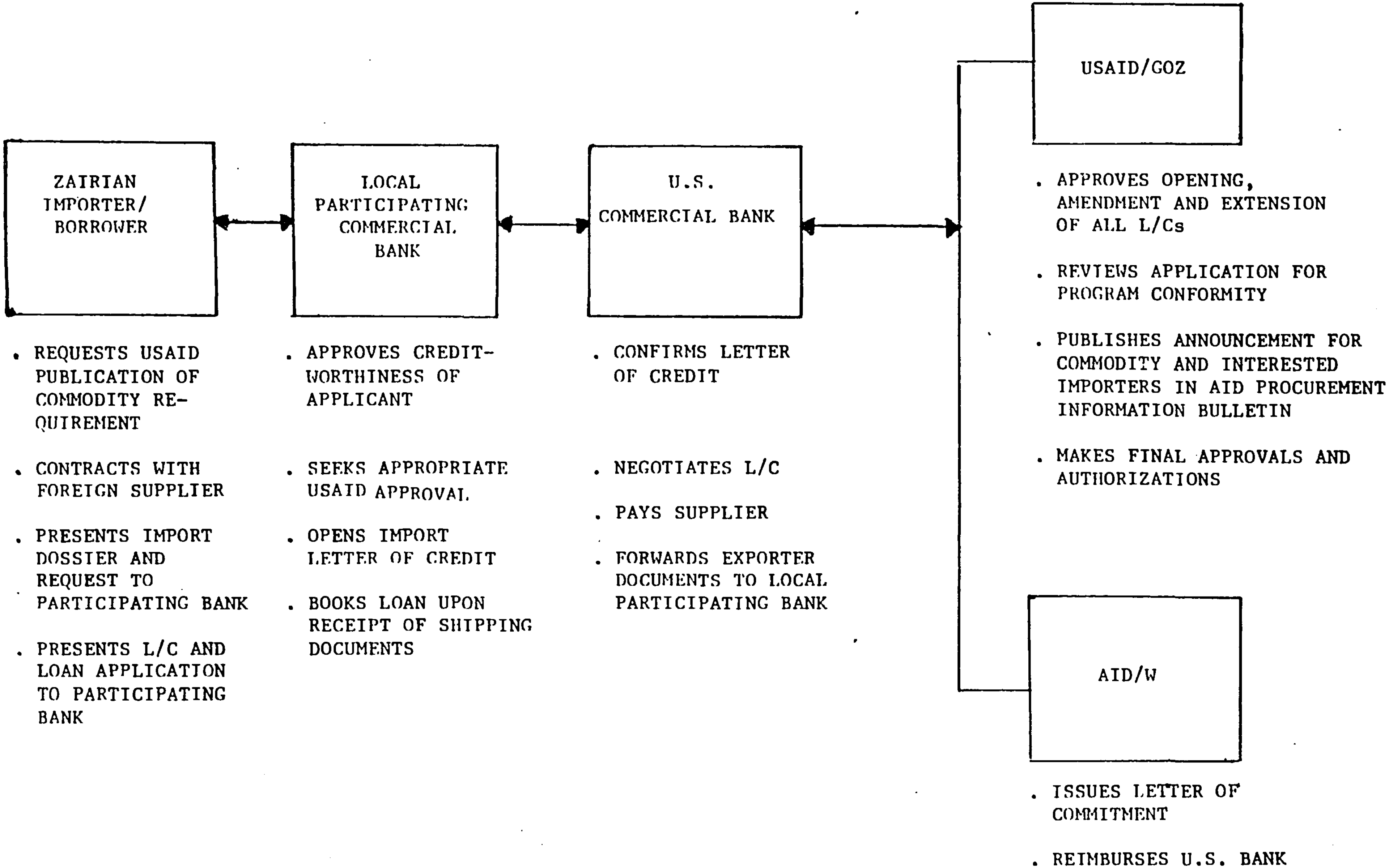

EXHIBIT 5.6

LOCAL CURRENCY CREDTI AND AMENDMENT FLOWS

PRIVATE SECTOR SUPPORT PROGRAM -

| ZAIRIAN BORROWER | LOCAL PARTICIPATING COMMERCIAL BANK | LOCAL FIDUCIARY BANK | LOCAL CURRENCY COUNTERPART FUND |
|---|---|---|---|
| . PREPARES LOCAL CURRENCY LOAN REQUEST | . REVIEWS AND APPROVES LOCAL CURRENCY LOAN REQUEST AGAINST AGREED CRITERIA ESTABLISHED BY USAID<br>. GRANTS LOAN AND BEARS CREDIT RISK<br>. COLLECTS FEES, INTEREST AND PRINCIPAL FROM BORROWER<br>. REMITS TO FIDUCIARY BANK PRINCIPAL AND INTEREST AS PER AGREEMENTS | . MANAGES, SCREENS, ACCOUNTS FOR AND AUDITS CPF PER AGREEMENTS WITH USAID<br>. HANDLES ALL LOCAL CURRENCY RELATIONSHIPS WITH LOCAL COMMERCIAL BANKS ON BEHALF OF USAID<br>. SEEKS APPROVAL AND AUTHORIZES ALL WITH DRAWALS, DEPOSITS AND REPAYMENTS TO CPF<br>. COLLECTS PRINCIPAL/INTEREST FROM PARTICIPATING BANKS AND REMITS TO CPF<br>. DOMICILES ALL BANK GUARANTEES | . SERVES AS OFFICIAL REPOSITORY AND MASTER ACCOUNT FOR ALL PROJECT LOCAL CURRENCY FUNDS |

- o Receive all payments of principal and interest to the counterpart fund account from the participating banks.

- o Collect due loans on maturity from participating banks and credit the CPF with the loan proceeds.

- o Issue monthly reports clearly detailing, per bank and per sector of activities: outstanding loans (grouped by maturity), aging of the past due loans, and types of products being financed.

(3) Reporting

The Fiduciary Bank is required to maintain adequate records and issue reports to USAID as covered in Implementation Procedures for Private Sector Financing, 7.6(2) below. All reports will show the transaction number and borrower's account number (of the participating bank).

(4) Remuneration

The Fiduciary Bank will be remunerated under a fixed fee dollar denominated contract to be paid in dollars and counterpart funds.

(5) Eligibility

To act as a Fiduciary Bank, a bank would have to meet the following criteria:

- o Be a private commercial bank operating in Zaire.

- o Be willing to submit to and be capable of having satisfied AID's accountability requirements for the previous three years and for the duration of the project.

- o Show evidence of efficient reporting and bookkeeping capabilities that can track and closely monitor the status of payment to the CPF for L/Cs and DL/COMs opened under the CIP, and for local currency loans approved under the LCLP.

- o Accept that while the Fiduciary Bank will be permitted to participate in opening letters of credit under the CIP, it must keep records to clearly distinguish its commercial bank activity from that of the Fiduciary Bank.

5.7 Management Information And Control Systems

Detailed analysis of dollar and zaire disbursements, document flows, approvals, and monitoring and control procedures for the CIP and local currency loan program are described in their actual sequence in Annex 7, Implemenation Procedures for Private Sector

Financing. Below are summaries of the major monitoring and reporting activities for the CIP and LCLP by each participating organization:

Part I: Providing Access To Foreign Exchange:

(1) By participating bank: The participating bank receives all requests from importers for foreign exchange. It reviews for conformance with USAID and GOZ policy and procedures to include the selection of the supplier. The participating bank then requests USAID/GOZ approval of each transaction. It draws up the promissory note to cover repayments to the CPF by the importer, agrees with the importer on collateral, sets the repayment periods, and makes collection of CPF from the importer.

- By USAID:
  - Prior to shipment of commodities: USAID reviews and jointly approves the transaction with the GOZ/Department of Plan. It approves the letter of credit prior to issuance, or issues a direct letter of commitment (if such is employed) after verifying that the import license has been validated. USAID establishes and maintains control over payment of CPF as required by each underlying promissory note, and/or corresponding credit to the CPF account at the Fiduciary Bank. Lastly, it evaluates the progress of the U.S. Bank handling letters of credit.
  - Subsequent to shipment: USAID follows up with the participating bank to confirm that shipping documnts have been negotiated with the importer. It uses the suspense file established when the supplier provided USAID with information copies of all shipping documentation. USAID then follows up with a receiving report to the importer and requests the local auditing firm to perform end-use checks to verify the actual receipt and utilization of commodities in terms of the original transaction approval. USAID continues to maintain control over the importer's payment of the CPF to the participating bank for the life of each promissary note, and the transfer of funds to the CPF account at the Fiduciary Bank. USAID reviews the status of deliquent accounts to include recommending the calling in of bank guarantees when the situation warrants. USAID receives periodic reports from the Fiduciary Bank and auditing firm, analyzes them and takes appropriate action.

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- By the Fiduciary Bank: The Fiduciary Bank establishes transaction controls upon receiving transaction summary documents from the participating bank and USAID. The Fiduciary Bank holds the Promissory Note endorsed by the participating bank and automatically debits the letter on maturity through the Central Bank's clearing system. The maintenance of constant status control on all repayments due is thus a major control responsible of the Fiduciary Bank.

- By the U.S. Bank: Where letters of credit are involved, the U.S. Bank is required to report monthly on the status of draw-down of AID funds and of payments against letters of credit. This report causes the U.S. bank to maintain up to date records covering each letter of credit and to report funds made available as letters of credit are closed out.

- By the GOZ Department of Plan: The GOZ Department of Plan initially exercises control when it jointly approves each transaction with the USAID. Subsequently, it may ask for information as to the status of the CPF account from either USAID or the Fiduciary Bank as required.

- By the Auditing Firm: The auditing firm performs end-use checks on MSE importer upon the request of USAID, and thus controls the eligibility of the imported goods and their appropriate end-use, and performs any other functions deemed necessary by USAID.

(2) Reporting

- By the Participating Bank: The participating bank will furnish the fiduciary bank the following documents or reports:

  - Copies of all letters of credit opened and amended, deleting the name of the account party.

  - Endorsed Promissory Notes by the participating bank. Transaction status report to the Fiduciary Bank will also be furnished to USAID.

  - Evidence of all deposits made to cover the foreign exchange cost of L/Cs and DL/COMs, if any.

  - A monthly report showing the status of all outstanding L/Cs and DL/COMs. This will include transaction number, importer's account number and the terms of payment and interest charged. In reporting Letters of Credit, the pertinent AID-Washington Letter of Commitment will be cited. A copy of the report will be furnished to AID.

- o <u>By the Fiduciary Bank</u>: The Fiduciary Bank is required to maintain adequate records and issue the following reports to USAID and the participating banks. All reports will show the transaction control number.

  - <u>Monthly Outstanding L/C and DL/COM Reports</u>: Indicates L/Cs and DL/COMs per bank, transaction number, commodities involved, L/C maturity or DL/COM expiration date, the value in dollars and Zaires, and pertinent interest rates and exchange rates. The report should include a section covering default from the borrowers and the value and transaction number of each one.

  - <u>Monthly Delinquent Loan Report</u>: Indicates overdue payments under L/Cs and DL/COMs broken down by bank and sector of activity, reasons for delinquency and age of overdue payments. Delinquency is required to be reported whenever an importer misses a payment and regardless of whether or not the bank itself repays the CPF. In all such cases the transaction number and number of the importer's account will appear in the report.

  - <u>A brief quarterly analysis and evaluation</u> of the import program, describing presumed reasons for low or high rate of overdue payments under the PSSP program, any problems encountered in interacting with the participating banks and any recommendations to improve the system.

Part II. <u>Local Currency Lending Program</u>

(1) <u>Monitoring And Control</u>

- o <u>By the Participating Bank</u>:

  - The participating bank receives all requests from MSE's to borrow local currency under the PSSP. The bank establishes the borrower's eligibility and credit risk for the transaction in question, and insures that proformas are provided when purchases of commodities (and related services) are contemplated, or that a procurement plan is provided when the loan proceeds are to be used for an agricultural buying program. The bank establishes the promissory note to cover repayments of the loan, agrees with the importer on collateral, sets period for repayment and makes collection.

  - The bank informs the Fiduciary Bank of the transaction, endorses the Promissory Note, hence authorizing the fiduciary bank to debit its account on maturity, and requests funds to cover the loan. It maintains follow up to insure that the Fiduciary Bank acts to release the funds within the stipulated one working day from the date of its request. Following receipt of the funds, disbursement is made either in the form of a check to a supplier to cover the goods being purchased, or in the form of a deposit to the borrower's account.

- By the Fiduciary Bank: The Fiduciary Bank establishes a transaction control file upon receiving a transaction summary, loan guarantee commitment and request for funds from the participating bank. The Fiduciary Bank maintains constant follow-up on the repayment schedule established for the repayment of each loan. The Fiduciary Bank holds the participating bank's guarantee or endorsed Promissory Notes for repayment of each loan. Thus, as in the case where foreign exchange is provided, the maintenance of constant status control and follow-up on all payments due to the CPF is a major responsibility of the Fiduciary Bank.

- By the GOZ/Department of Plan: The GOZ/Department of Plan remains concerned over the use of the counterpart funds, the benefits derived and the timely repayment of funds that are loaned. To this extent, the GOZ will periodically request status and progress information from the Fiduciary Bank. Likewise, USAID will bring up matters jointly with the GOZ and banks concerned when reported data indicate such action is warranted.

- By the Local Auditing Firm: The auditing firm performs end-use checks of locally financed goods upon the request of USAID. These checks serve to verify the eligibility of the goods and the appropriateness of their end-use.

(2) Reporting

o By the Participating Bank: The participating bank will supply the fiduciary bank with the following documents and reports::

  - Loan Application Files: a copy of each complete loan application file after the bank has approved the loan. The file will include the borrower's request for a loan, pro-forma invoices or procurement plans, the banker's loan approval and transaction number, repayment schedule of principal and interest, copies of paid invoices, and receiving reports for goods or warehouse receipts for agricultural commodities, and endorsed Promissory Notes.

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- Monthly Status Report on LCLP Account indicating the amount of local currency approved for loans by the participating bank, amount received from the Fiduciary Bank to cover these loans, and the amount actually disbursed on each transaction. The report will identify each loan by the transaction number and the borrower's account number.

o By the Fiduciary Bank: The Fiduciary Bank will furnish USAID with the following reports:

  - Monthly LCLP Escrow Account Statement: Indicates the status of the CPF escrow account and related activities. Transfers into the escrow account from the regular CPF account will be shown with references to the USAID/GOZ authorization. Monthly and overall cumulative drawdowns against the LCLP escrow account per participating bank will be identified by pertinent transaction numbers and the borrowers' account numbers. Loan activities will be separated for each participating bank.

  - Monthly Outstanding Loan Report: Indicates outstanding loans per bank and per sector of the borrowers' activity and loan tenor, maturity and interest rates. Loans will be identified by the transaction number and the borrower's account number.

  - Monthly Delinquent Loan Report: Indicates overdue loans per bank and per sector of activity, reasons for delinquency and age of overdue loans. Required whenever a borrower misses a payment and regardless of whether he bank repays the CPF. Loans will be identified as in the monthly report.

  - A Brief Quarterly Analysis/Evaluation of the loan program, describing the reasons for low or high rate of credit utilization under the PSSP program, problems encountered in interacting with the participating banks, and recommendations to improve the system.

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EXHIBIT 5.3A

## PROGRAM MANAGEMENT STRUCTURE - KEY POSITION DESCRIPTIONS

- PRIVATE SECTOR SUPPORT PROGRAM -

| POSITION TITLE | MAJOR RESPONSIBILITIES | PRIMARY QUALIFICATIONS |
|---|---|---|
| PROGRAM MANAGER | 1. Prepare long range and year ahead plans, budgets and schedules for all activites of the PSSP. | 1. Have three to six years experience in public and private sector business or economic development activities, Experience in Africa highly desirable Experience in AID-related activities desirable. |
| | 2. Develop and install accounting monitoring and evaluation systems for assessing performance against plan. | |
| | 3. Establish work scopes, issue requests for proposals, qualify consultants, propose contract awards and supervise work of outside research, audit and consulting firms retained for PSSP studies, research, audits and evaluations. | 2. Demonstrate understanding and experience in international trade finance and commercial bank operations. |
| | | 3. Possess an advanced degree or its equivalent in business, economics, or the social sciences. |
| | 4. Prepare periodic and special reports on progress against plan, and make appropriate recommendations. | 4. Demonstrate successful experience in the supervision of multi-disciplinary teams, and in the development and presentation of effective written and verbal reports. Consulting experience desirable. |
| | 5. Supervise and evaluate the work of the Financial Sector Economist, the Program Economist and the PSSP CIP officer. | 5. Possess fluency in English and a S3/R3 level in French. |
| | 6. Maintain close working relationships with key officials in the GOZ, the participating and fiduciary banks and private sector beneficiaries. | 6. Demonstrate an ability to gain the confidence and acceptance of policy making officials and executives in the public and private sectors. |
| | 7. Report and be responsible to the USAID D/PDO executive responsible for Mission project control. | |
| | 8. Ensure that all conditions, agreements and contracts between USAID and GOZ, participating and fiduciary banks, consultants and auditors are complied with and that compliance with such terms and conditions are reported with appropriate recommendations. | |
| | 9. Ensure that all PSSP activities are carried out in accordance with AID and Mission policies, procedures and approval authorities, and that all reporting requirements are observed. Consult with the D/PDO on all issues related to approval authorities. | |

| POSITION TITLE | MAJOR RESPONSIBILITIES | PRIMARY QUALIFICATIONS |
|---|---|---|
| PROGRAM ECONOMIST | 1. Advise the PSSP Program Manager on all aspects of the survey, monitoring and evaluation activities of the PMU.<br>2. Participate in the research and analysis activities of the Financial Sector Economist of the PMU and provide him with appropriate counsel and assistance.<br>3. Prepare research plans and budgets.<br>4. Head the Mission's Research Committee.<br>5. Conduct selected economic and social research studies.<br>6. Monitor and evaluate on-going program research sponsored by USAID or in collaboration with other interested agencies.<br>7. Define and specify research projects, draft RFPs, qualify and recommend consultants, and supervise and/or participate in research and evaluation projects. | 1. Possess an advanced degree in economics anthropology, or related social science field in which quantitative analysis is an important requirement.<br>2. Have strong analytical and quantitative skills, and the ability to plan, review, and advise on research proposals and methodology in both English and French (R3/S3).<br>3. Demonstrate outstanding verbal and written presentation skills.<br>4. Have previous experience in developing country environments, preferably in Africa. |
| COMMODITY IMPORT OFFICER | 1. Organize and direct the activities of the PSSP commodity import activities. Report and be accountable to the PSSP Program Manager. Consult with the Program Manager to ensure that all internal procedures are designed to satisfy statutory and Mission policies in regard to approval authorities.<br>2. Establish management information reporting and control systems for the CIP activities and ensure their adequacy in meeting all operational, control and statutory reporting requirements.<br>3. Review applications and proposals and recommend approval for utilization of the foreign exchange and local currency elements of the PSSP to ensure conformity with all PSSP beneficiary criteria.<br>4. Ensure that all actions have been taken to ensure accurate and timely issuance of commitment letters. | 1. Have two years of private sector experience. Experience in Africa desirable. An understanding of USAID field operations and CIP progress very helpful.<br>2. Demonstrate successful supervisory experience and the ability to deal effectively with high level officials and executives.<br>3. Develop ideas and recommendations in effective written and verbal presentations.<br>4. Possess fluent English and S3/R3 level French.<br>5. Have a university degree preferably in business, economics or the social sciences. |



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| POSITION TITLE | MAJOR RESPONSIBILITIES | PRIMARY QUALIFICATIONS |
|---|---|---|
| COMMODITY IMPORT OFFICER | 5. Assist in the establishment and installation of systems, procedures and reporting requirements for the fiduciary bank selected to monitor and report on the local currency counterpart fund. Evaluate and assess the activities of the fiduciary bank and make appropriate reports and recommendations. | |
| | 6. Maintain continuing operational contacts with participating private sector commercial banks in Zaire and advise and assist them in securing PSSP objectives. | |
| | 7. Remain in contact with U.S. confirming and negotiating banks to ensure prompt and accurate handling of all transactions referred to them, and expeditious payment to authorized exporter-suppliers. | |
| | 8. Contact on a continuing basis private sector MSE's participating in the PSSP to determine program effectiveness and impact. | |
| | 9. Establish control systems, in particular appropriate domiciling of all avalized notes and bank guarantees, to ensure that participating commercial bank repayments are made in conformity with agreements and contractual responsibilities. | |
| | 10. Work closely with monitoring, evaluation, impact and other consulting and research teams engaged in assessing PSSP performance and recommending changes, extension or addition to private sector support program activities. | |

**POSITION TITLE**: FINANCIAL SECTOR ECONOMIST

**MAJOR RESPONSIBILITIES**

1. Act as advisor to the Bank of Zaire on financial and banking system reform, in particular reform targets and schedules contained in GOZ/USAID PSSP agreements.

2. Establish practical policy reform conditionalities and benchmarks and recommend qualitative and quantitative measures of GOZ performance in attaining these benchmarks. Follow progress of the GOZ in meeting agreed conditions and benchmarks. Consult with and assist GOZ officials as directed in developing policy and program approaches to meeting agreed conditionalities and benchmarks, and work closely with them in implementing agreed programs. Prepare reports for GOZ and/or USAID us in assessing progress, recommending next steps, and studying new approaches to agreed reform objectives.

3. Remain aware of major macro economic developments and programs impacting structural adjustment programs with specific reference to the private sector and the finance and banking sector.

4. Maintain close and continuing contacts with representatives of the World Bank/IMF, the donor community, the U.S. Embassy and USAID on matters related to macro economics, policy reform, banking sector reform and private sector development.

5. Conduct and/or participate as a team member on research surveys and prepare reports on areas of interest to the PSSP.

6. Advise and prepare background and briefing papers for USAID officials engaged in policy reform discussions and negotiations with the GOZ and the donor community.

7. Prepare work scopes, assist in qualifying consultants, and direct, supervise and/or participate in special surveys related to PSSP objectives.

8. Organize and conduct seminars, orientation and training sessions for GOZ and/or USAID personnel on macro economic issues and developments, progress in achieving PSSP objectives, and results of on-going PSSP research.

**PRIMARY QUALIFICATIONS**

1. Have a minimum of fifteen years of experience in international finance and banking, preferably in both the public and private banking sectors. Developing country experience essential. Experience in Africa highly desirable. World Bank/IMF/USAID experience very relevant.

2. Demonstrate outstanding ability to work on major national economic issues at high levels. Able to present ideas clearly in persuasive written and verbal presentations.

3. Be a mature and articulate individual able to gain the confidence and acceptance of policy level officials and executives.

4. Demonstrate practical experience and current familiarity with structural adjustment issues, problems and solutions particularly relating to central bank finance and banking systems reforms in a developing country environment.

5. Possess an advanced degree in economics finance and banking or business.

6. Be fluent in English and French (S4/R4).

ANNEX 6

# PROPOSED RESEARCH, EVALUATION AND IMPACT STUDIES AND HUMAN RESOURCE DEVELOPMENT

- PRIVATE SECTOR SUPPORT PROGRAM -

## PROPOSED RESEARCH, EVALUATION AND IMPACT STUDIES AND HUMAN RESOURCES DEVELOPMENT

### - PRIVATE SECTOR SUPPORT PROGRAM -

The purpose of this Annex is to provide activity summaries, schedules and budgets for consulting and technical assistance required to carry out research, monitoring and impact studies, policy dialogue conferences and workshops, and PSSP-related human resources development activities. These activities have been designed as integral elements of the PSSP over the five-year life of the project.

The special studies suggested here have four major objectives:

- To improve the management, implementation and development of the PSSP, specifically the financial/credit component and the policy reform component;
- To indicate directions for future projects in private sector development including:
  - identifying efficient industries, studying means of increasing the value-added sector in Zairian industry
  - examining domestic savings mobilization and credit in the informal sector as means to understanding smaller MSEs' financial needs
  - researching the problems and potential of women as workers and business owners in the private sector
- To monitor impacts of the Project on traditional AID target groups - the urban and rural poor, women - through surveys of participating MSEs and special studies on the informal sector and women in the private sector;
- To generate data for the evaluation of the Project.

The project summaries which follow provide the following information on each of the proposed activities:

- Activity Title and Purpose
- Fiscal Year Schedule
- Estimated Person Months
- Estimated Budget

Exhibit 6.1 provides a one-page summary of these activities. The studies suggested should be considered an illustrative list and may not all be implemented as they appear here. Their total cost must not exceed the $950,000 set aside in the PP for studies and monitoring (see Exhibit 6.2 for disbursement schedule).

EXHIBIT 6.1

PROPOSED RESEARCH, EVALUATION AND IMPACT STUDIES AND HUMAN RESOURCES DEVELOPMENT

- PRIVATE SECTOR SUPPORT PROGRAM -

| | TITLE | EST. FY | BUDGET Dollars | LC $ Equiv. |
|---|---|---|---|---|
| 1 | Survey Impact of PSSP on Private Sector Participants | 1,2,3,4 | $124,800 | 118,464 |
| 2 | Design and Install PSSP Management and Information Control System | 1 | 43,857 | |
| 3 | Survey Informal Sector Savings and Credit Activities | 1 | 21,040 | 9,652 |
| 4 | Survey Private Sector Business Development Opportunities for Local Inputs and Export | 2 | | 20,747 |
| 5 | Conduct Economic, Finance and Banking Studies | 1,2,3,4 | 136,971 | 78,496 |
| 6 | Conduct PSSP Seminars and Conferences | 2,5 | 66,900 | 3,872 |
| 7 | Sponsor Human Resources Development Activities | 2,3,4,5 | 227,865 | |
| 8 | Women in the Formal Private Sector | 2 | | 20,747 |
| 9 | Policy Reform Programs/ Donor/Coordination | 5 | 9,724 | 6,823 |
| 10 | Analysis of Potential for Increasing Generation of Foreign Exchange | 5 | ______ | 10,036 |
| | Subtotal | | 631,157 | 268,837 |
| | Total | | 899,994 | |
| | Studies Program Contingency | | 50,000 | |
| | TOTAL Studies Budget | | 949,994 | |

EXHIBIT 6.2

IMPLEMENTATION OF RESEARCH, EVALUATION AND IMPACT STUDIES, AND HUMAN RESOURCES DEVELOPMENT [1]

| FY Disbursements | | 1<br>$185,000 | 2<br>$245,000 | 3<br>$205,000 | 4<br>$175,000 | 5<br>$140,000 | TOTAL<br>$950,000 |
|---|---|---|---|---|---|---|---|
| Study 1 | $ | 28,200 | 30,200 | 32,200 | 34,200 | | 124,800 |
| | LC | 15,653 | 23,333 | 32,812 | 46,666 | | 118,464 |
| Study 2 | $ | 43,857 | | | | | 43,857 |
| | LC | | | | | | |
| Study 3 | $ | 21,040 | | | | | 21,040 |
| | LC | 9,652 | | | | | 9,652 |
| Study 4 | $ | | | | | | |
| | LC | | 20,747 | | | | 20,747 |
| Study 5 | $ | 38,905 | 43,538 | 41,795 | 12,733 | | 136,971 |
| | LC | 23,302 | 13,672 | 36,651 | 4,871 | | 78,496 |
| Study 6 | $ | | 30,000 | | | 36,900 | 66,900 |
| | LC | | 1,430 | | | 2,442 | 3,872 |
| Study 7 | $ | | 50,756 | 54,557 | 58,776 | 63,776 | 227,865 |
| | LC | | | | | | |
| Study 8 | $ | | | | | | |
| | LC | | 20,747 | | | | 20,747 |
| Study 9 | $ | | | | | 9,724 | 9,724 |
| | LC | | | | | 6,823 | 6,823 |
| Study 10 | $ | | | | | | |
| | LC | | | | | 10,036 | 10,036 |
| Studies Pro. Contingency Fund | | | | | | | 50,000 |
| TOTAL | | $180,609 | $234,423 | $198,015 | $157,246 | $129,701 | $949,994 |

1. Refer to Exhibit 2.2, Table I (3) in Section 2.
   LC = Local Currency ($ Equivalents)

## PROPOSED RESEARCH, EVALUATION AND IMPACT STUDIES

## AND HUMAN RESOURCES DEVELOPMENT

### - PRIVATE SECTOR SUPPORT PROGRAM -

| TITLE AND PURPOSE | EST. FY | EST. PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|
| 1. Survey Impact of PSSP on Private | 1 | 1 | 28,200 |
| Sector Participants in the Foreign | 2 | 1 | 30,200 |
| Exchange and Local Currency | 3 | 1 | 32,200 |
| Lending Program | 4 | 1 | 34,200 |

An annual assessment of private sector beneficiaries under both the foreign exchange and local currency components of the PSSP. See Annex 4, Social Soundness Analysis, for sample survey questions. These impact studies have several objectives:

1) Assess changes in the investment climate.

2) Determine specific improvements resulting from foreign exchange and local currency loans in private sector investments, productivity, cost reduction, capacity utilization, financial status, profitability of new products, local purchase of goods and services, market expansion, employment, etc.

3) Draw conclusions on program effectiveness and make appropriate recommendations. Recommend, as appropriate, concept proposals for new project designs, or changes in PSSP priorities, conditionalities and approach.

| | |
|---|---|
| | $124,800 |
| | LC118,464 |
| al Estimated Costs | 243,264 |

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| TITLE AND PURPOSE | EST FY | EST PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|
| 2. Design and Install PSSP Management Information and Control System | 1 | 2 | 43,857 |

Specifications for the PSSP Management Information and Control Reporting System have been completed. (See Annex 2, Administrative Analysis.) Detailed system design, installation and trouble shooting will begin in month one of project implementation, with installation and debugging carried out during months 2 through 4. Costs estimated on basis of use of local consulting firm.

Total Estimated Costs 43,857

| | | | |
|---|---|---|---|
| 3. Mobilization of Domestic Savings and Informal Credit Activities | 1 | 4 | 21,040 |

Informal sector savings and credit activities are estimated to be large and important in both urban and rural areas of Zaire. This study will assess possibilities of encouraging or working through this sector for providing credit or technical assistance to smaller enterprises, in which are included most women-owned enterprises. The study would employ one expatriate and one local consultant to conduct sampling studies in three to four key rural and urban areas with a view to gauging impact of the informal lending sector and assessing possibilities of encouraging expansion of these activities. The research will examine issues such as savings mechanisms, investment strategies of small businesses, access to credit in the informal sector, and links between the formal and informal sectors and with agriculture, and will include a review of the literature on credit unions in Zaire.

Total Estimated Costs $21,040<br>LC6,952<br>27,992

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| TITLE AND PURPOSE | EST. FY | EST. PERSON MONTHS | BUDGET LC |
|---|---|---|---|
| 4. Survey Opportunities For Encouraging Development Of Private Sector Businesses Utilizing Local Sources Of Materials For Both Local And Export Markets | 2 | 1-2 | 20,747 |

The objective of this survey is to determine the possibilities for development or expansion of local private sector organizations utilizing locally produced inputs, and to assess the export market potential for their products. A pilot sample of existing companies or cooperative groups producing products with high local content would be selected and examined to determine the feasibility of designing specific assistance programs. Export potential for these products would be assessed. The research findings, if positive, would be developed in the form of a pre-PID type proposal.

Total Estimated Costs LC20,747

TITLE AND PURPOSE

5. Finance and Banking Services

The PSSP provides for the conduct over the life of the program of a series of inter-linked assessments and surveys of the national finance and banking sector having as a key objective the proposal of action recommendation for the banking system in providing term credit to private sector MSES. These studies would propose and assess possible measures for:

- Encouraging savers to use and to encourage formal bank savings and deposit systems.
- Encouraging inter-bank lending mechanisms.
- Achieving market determined exchange and interest rates.
- Encouraging banks to increase local currency term lending to MSE's.
- Financing an increasing share of the national fiscal deficit from local savings mobilization.
- Measuring the impact of stabilization policies and programs on financial sector performance.

Surveys currently under discussion and planned are summarized below. It will be the responsibility of the PSSP Program Management Unit to develop appropriate RFPs and monitor consultants contracted for the work.

| TITLE AND PURPOSE | | EST. FY | EST. PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|---|
| 5.1 | Financial Markets. Evaluate the potential for secondary financial markets and/or private sector instruments. Recommend possible programs to encourage their development. | 1 | 2 | 38,905 |
| 5.2 | Survey Central Bank Financial Products for use as open market policy instruments. | 2 | 1 | 24,706 |
| 5.3 | Survey Methods And Systems For Measuring And Evaluating Impact Of Structural Adjustment On Banking Sector Growth In Capital Investment, Local Currency Deposits And Private Sector MSE Term Credit. | 2 | 1 | 18,832 |
| 5.4 | Survey Follow-up, Detailed Design Of Action Recommendations, And Implementation Technical Assistance. | 3 | 3 | 41,795 |
| 5.5. | Evaluate And Make Recommendations For Direct Financial Incentives To The Banking Industry In Creating Additional Real Growth In Bank Capital And Local Currency Bases. | 4 | 1 | 12,733 |
| Total Estimated Costs | | | | $136,971<br>LC78,496<br>215,467 |

| TITLE AND PURPOSE | EST. FY | EST. PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|
| 6. PSSP Seminars And Conferences | 2 | 1 | 30,000 |
| | 5 | 1 | 36,900 |

A seminar-conference element has been budgeted into the PSSP as a device to obtain several objectives:

- o Maintain contacts with, solicit advice from and obtain understanding and support of public and private sector decision makers and program participants.
- o Communicate program objectives and accomplishments,
- o Encourage private-public sector dialogue on private sector development issues,
- o Feed back the results of the PSSP research program and provide a forum for presentation of new ideas,
- o Utilize the seminars for obtaining public awareness of USAID efforts via appropriate public relations, information, and follow-up publication of proceedings.

Two seminars have been planned over the LOP: One in year two; the other in year five.

| | |
|---|---|
| | $66,900 |
| | LC3,872 |
| Total Estimated Costs | 70,772 |

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| TITLE AND PURPOSE | EST. FY | EST. PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|
| 7. <u>Human Resources Development</u> | 2 | | 50,756 |
| | 3 | | 54,557 |
| | 4 | | 58,776 |
| | 5 | | 63,776 |

The achievement of PSSP objectives implies substantial and continuing changes in Zaire's central banking, finance and commercial banking communities. Key decision makers and senior operating executives in the private commercial banking sector and the GOZ whose understanding and cooperation are essential to project success will benefit from exposure to policy and operating structures and systems, and dialogue with counterparts in modern free enterprise banking environments.

The PSSP proposes a buy-in to the HRDA program for highly selective overseas working and orientation tours within the central banking, finance and commercial banking sectors. Program scope, selection criteria, administration and schedules will be developed and proposed by the PSSP Program Management Unit during year one of the project. Implementation will be scheduled over years 2, 3, 4 and 5. Provision has been made for twenty orientation tours over the LOP.

| | |
|---|---|
| Total Estimated Costs | 227,865 |

| TITLE AND PURPOSE | EST FY | EST PERSON MONTHS | BUDGET LC |
|---|---|---|---|
| 8. <u>Women In The Formal Private Sector</u> | 2 | 2 | 20,747 |

At this time, women do not play a large role in the formal private sector, either as workers or owners of businesses. Other projects will be assisting women entrepreneurs in smaller businesses through ANEZA and BEDEPE. Further research on informal sector financial institutions will enable the Project to determine ways to reach the vast majority of women-owned businesses with credit and technical assistance.
This research is designed to evaluate the problems and possibilities of women in the formal private sector. The study will be funded in local currency and employ local consultants working in the women and development sector, such as CEFD. The research has a threefold objective:

- o Research the legal and social barriers to women's entry into the formal private sector;
- o Evaluate women's productivity in business and industrial activities through fieldwork in participating MSEs;
- o Recommend interventions which will help women to work in the private sector.

The researchers will, in addition, collect case histories of women workers and business owners in the formal private sector.

Estimated Total Costs LC20,747

| TITLE AND PURPOSE | EST FY | EST PERSON MONTHS | BUDGET DOLLARS |
|---|---|---|---|
| 9. <u>Policy Reforms/Donor Coordination</u> | 5 | 1 | 9,724 |

Policy reform programs are often criticized for being too demanding and too extensive, and for lacking clear priorities. They are also criticized for failing to recognize the capacity of host governments, national economies, and the people to absorb, digest, and respond to policy reform programs. This study will examine the absorbtive capacity of Zaire for policy reform, donor coordination, and the establishment of policy reform priorities.

| | |
|---|---|
| | $9,724 |
| | LC6,823 |
| Estimated Total Costs | 16,547 |

| TITLE AND PURPOSE | EST FY | EST PERSON MONTHS | BUDGET LC |
|---|---|---|---|
| 10. Analysis of Potential For Increasing Generation of Foreign Exchange | 5 | 3 | 10,036 |

In order to relieve chronic foreign exchange shortages, Zaire must encourage the development of efficient industries that benefit from Zaire's comparative advantage in international markets. These might be import substitution industries which would produce a net savings of foreign exchange or export industries generating new sources of foreign exchange. Thus, through future investment programs Zaire could focus on investment in more efficient, profitable industries. This study would therefore do the following:

- o Evaluate the comparative advantages of Zairian industry/agriculture/commerce in world markets;
- o Assess government tariffs, taxes, and subsidies affecting Zairian industry's international competitiveness;
- o Identify efficient, competitive industries or emerging industries which might be developed or expanded, and inefficient, protected businesses which should not receive special government assistance;
- o Recommend policy reform measures to help improve the investment climate and Zairian industrial competitiveness;
- o Propose projects/programs to encourage foreign investment in targeted sectors/industries and to increase Zairian exports/import substitution.

Total Estimated Costs LC10,036

ANNEX 7

# IMPLEMENTATION PROCEDURES FOR PRIVATE SECTOR FINANCING

- PRIVATE SECTOR SUPPORT PROGRAM -

ANNEX 7

# IMPLEMENTATION PROCEDURES FOR PRIVATE SECTOR FINANCING

- PRIVATE SECTOR SUPPORT PROGRAM -

## 7.1. Introduction

This Annex describes in detail the requirements and procedures for both the foreign exchange and local currency lending components of the PSSP.

It discusses first the Commodity Import Program (CIP) Approach which forms the basis of the foreign exchange lending program (Section 7.2). A table (7.2) and Section 7.2(2) show the commodities eligible for importation under the program, and other eligibility requirements are set forth in Sections 7.2,(1), (3), (5), and (7). Section 7.3 details the procedures to be followed in applying for the loans. Payment of loans into the Counterpart Fund is discussed in Section 7.4 and the role of USAID is outlined in Section 7.5.

Section 7.7 describes the PSSP Local Currency Lending Program, including eligibility requirements and local currency loan disbursement methods. Measures designed to encourage banks to disburse funds rapidly and to increase their list of MSE clients are discussed.

Finally, the Annex details procedures related to the local currency lending program (LCLP), repayment to the Counterpart Fund and the role of USAID. For a detailed discussion of the role of the Fiduciary Bank, see Annex 5 (5.6), The Administrative Annex.

## 7.2. The Commodity Import Program (CIP) Approach

The PSSP will make foreign exchange available to private importers through local commercial banks. It will use mechanisms for disbursing dollars similar to those currently employed in USAID's Commodity Import Program (CIP). Transactions will be approved according to AID Regulation I. Payments to suppliers will be done through irrevocable letters of credit or AID Direct Letters of Commitment.

Local importers will repay the local currency equivalent of the value of the imports to the Counterpart Fund (CPF) account calculated at the U.S. dollar buying exchange rate on the day of the opening of the letter of credit or AID Direct Letter of Commitment. The importer's CPF repayments will be guaranteed by its local participating bank. The participating bank will establish repayment terms and conditions, assume credit risks, collect local currency repayments and interest, and remit local currency to the bank designated to maintain and control the Counterpart Fund account, hereinafter known as the "Fiduciary Bank".

The obligation to the Counterpart Fund will not be contingent on payment by the borrower to the participating bank. Interest will accrue from the day the shipping documents are negotiated. The program will put no constraints on lending/or arrangements between the bank and the importer as to collateral, fees, or repayment terms, except that final repayment will be limited to the periods shown in Exhibit 7.1.

Since the transaction is fully funded by an in-flow of foreign exchange provided under terms of the program agreement, the central bank has agreed that the overall lending ceiling and the individual ceiling for the participating bank will not be affected. Repayments will be independent of foreign exchange rate, so that the bank and the borrower will bear no foreign exchange risk. However, the bank's ceiling could be affected should it choose to lend local currency to an importer in order to cover CPF repayments.

(1) Eligible Importers

Eligible importers are medium and small enterprises (MSEs). The PSSP has defined medium and small enterprises as those firms with less than 500 employees and/or total annual sales not exceeding the equivalent of roughly $5.0 million. As demonstrated in the Coopers and Lybrand studies, there are at least 40-50 such companies that fulfill these criteria, are interested in the PSSP, and are creditworthy at local commercial banks. In addition, roughly twenty-five percent of those firms identified by C & L as potential recipients have already benefited from previous CIPs. There will be no exceptions to the target group of MSEs authorized to participate in the PSSP.

(2) Eligible Commodities

Exhibit 7.2 (Sample Eligibility List of Commodities), contains a sample list of suggested items that are to be excluded from PSSP financing. As under the previous CIPs, the PSSP will emphasize and encourage foreign exchange financing of goods for agricultural, agro-industry and transport. It will also consider financing requirements of general industry and construction firms where their activities support the growth and development of Zaire's indigenous private sector.

(3) Source And Origin Of Eligible Commodities

The PSSP will be funded from the Development fund for Africa (DFA), which has a blanket Code 935 source/origin authorization. The PSSP will however, be implemented as Code 941 project where use of foreign exchange is concerned. Such was the authorized code for the AEPRP (0121), which proved to be most appropriate for attracting a large number of participants and rapidly disbursing the funds.

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The AEPRP financed equipment and some raw materials from the U.S. It also financed a variety of raw materials, equipment, and machinery from such countries as Brazil, Bangladesh, and Israel. Generally these were imports that were not available in the U.S. In any case, companies that participated in the AEPRP were able to purchase everything they sought in either the U.S. or a 941 country. No waivers were issued to finance European or Japanese goods.

The PSSP expects that nearly all of the foreign exchange will be used to finance 941 commodities. Only in rare cases, perhaps for Canadian or European-brand spare parts, will USAID finance 935 items. For goods to be purchased from 935 countries, USAID will require proof that the items are not available in 941 countries or that the U.S./941 price is significantly higher than that from the 935 source.

Nevertheless, USAID intends to publicize the PSSP as 941 source/origin project, and encourage local companies to look first to the U.S., then to developing countries, for their imports.

(4) Rapid Disbursement

Experience with the CIP-AEPRP (660-0121) suggests that restriction to code 941 will be a successful approach to effective implementation and rapid disbursement, and one that will also satisfy the intent of the Continuing Resolution concerning use of DFA funds.

The PSSP is expected to attract enough MSEs for rapid dollar disbursement. In effect, the past experience of local banks and certain MSEs with the CIPs, and the Zairian business community's awareness of USAID's CIPs, coupled with the acute foreign exchange shortage in Zaire, strongly suggest that PSSP dollars could be committed within months of the project approval.

As noted, USAID recently achieved such rapid disbursement in its CIP-AEPRP which has taken place under similar economic conditions. We see that the covenants and CPs of the AEPRP were satisfied in April 1987 and USAID began approving transactions in June 1987. By January 1988 all $14.8 million for commodities was committed. In contrast, under the two earlier CIPs (660-0100 and 660-0103) it took four and three years respectively to commit and disburse the CIP funds, due in part, to the source and origin being 000 (USA), the then high value of the U.S. dollar and changing economic conditions.

(5) Eligible Amounts Per Transaction

The minimum amount eligible per transaction is $10,000. The maximum amount eligible is $300,000 for raw materials and spare parts, and $800,000 for capital investments (e.g. machinery, heavy equipment). Each MSE will be limited to one transaction per six months. This will enable the greatest number of MSEs to benefit from each release of dollar funding.

(6) Authorized Means For Paying Suppliers

Suppliers are payable:

- o By an irrevocable Letter of Credit issued by one of the participating banks (also known as "approved applicant" banks) listed in Section 7.2(7) below, and payable by an American Bank. Bank Letters of Commitment (BL/COM) will be issued by AID/W to one or more U.S. banks. USAID has had particularly good results in CIP 0121 with Riggs National Bank (Washington, D.C.) and UBAF Arab American Bank (New York). These two banks have provided USAID with comprehensive monthly reports on the status of the BL/COMs and all letters of credit issued under them.

- o Directly by AID/Washington against Direct Letters of Commitment issued by USAID/Zaire, either to an American supplier when this the CIP value exceeds US $500,000 (five hundred thousand US dollars) or equivalent in another eligible currency, or to a supplier from other eligible countries for any amount. The method to be applied will be indicated in the USAID/GOZ approval document.

(7) Eligible Banks

The following approved banks may participate under the PSSP:

- Citibank (Zaire) S.A.R.L.
- Union Zairoise de Banques (U.Z/B.)
- Banque Grindlays International au Zaire (BGIZ)
- Banque Commerciale Zairoise (B.C.Z.)
- Barclays Bank, S.Z.A.R.L.
- Banque Internationale pour L'Afrique au Zaire (BIAZ)
- Banque Continentale Africaine au Zaire (BACAZ)

All seven local private banks listed are eligible to participate in the PSSP, and all have expressed interest in the project. See Annex 2 and The Technical Analysis for a discussion of the commercial banking system.

The two largest banks, Banque Commerciale Zairoise (BCZ) and Union Zairoise de Banques (UZB) are Zairian banks with long-established ties to major Belgian banks. The other five banks are branch offices of major American, British and French banks. Except for 2 banks, all the private banks have participated in USAID's CIPs for the past four years, and are familiar with the CIP request, approval and disbursing procedures.

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## 7.3 Procedures

### (1) Solicitation of Quotations

1. Importers must solicit from several suppliers as many quotations as possible for the contracts they intend to enter into. Solicitations for quotations should be written in such a way that the contracted transaction can be paid under the PSSP. Any purchase contracts entered into will be contingent upon the importers receiving approval for AID financing. If contracts are entered into, importers will inform suppliers that:

   - the suppliers shall comply with AID Regulation 1; and
   - payments will be made in accordance with the provisions of 7.2(6) above.

2. Offers from more than one supplier are not required:

   - if the importer is purchasing, as the supplier's regularly authorized distributor or dealer, for resale or processing, a commodity which, under the terms of distributorship or dealership agreement, the importer is precluded from buying from another supplier; or

   - if the importer is purchasing for resale a commodity, the trademark of which is registered, from a supplier who is the sole distributor of this commodity in the importer's area.

   The interested importers will submit to USAID/Zaire copies of purchase contracts referred to above as well as current evidence of being a distributorship or dealer.

3. The importers should keep a record of each offer received, including:

   - the date of receipt;
   - the bid price;
   - the date the order is placed;
   - the reason for having accepted or rejected the offer (bid).

   Records should be maintained and kept at USAID/Zaire's disposal for a period of at least 3 (three) years from the date the order is placed. The same applies to the documents in support of the offers received and to the purchase contracts entered into.

4. The suppliers' offers, performance invoices or other documents in lieu thereof, should specify all necessary data to help identify:

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- the supplier/seller and the buyer;
- the country of the supplier/seller;
- the nature of the commodities, including the U.S. Department of Commerce Schedule "B" Code. This Schedule is available from the above mentioned Department and local American Embassies and Consulates which can provide relevant information to suppliers or sellers in eligible countries other than the U.S.;
- the source and origin country of the goods;
- the period of validity of the offer;
- the terms of delivery and payment.

(2) Approval Of Transactions By The Department Of Plan And USAID/Zaire

Upon receipt of offers, the importers shall:

1. Submit the original of all offers received with a cover letter to the participating banks of their choice to request financing under this PSSP, indicating in the cover letter the information stipulated in 7.3(3) above.
2. The participating bank will determine whether the transaction complies with all instructions of USAID and GOZ and, after verification, will send the eligible transaction files to USAID/ZAire.
3. After verification, USAID/ZAIRE and the Department of Plan will approve the transaction. Each approval document will be given a transaction number by USAID to be quoted in every related correspondence or document including CPF repayments. The original approval is sent to the bank and a copy to the importer.
4. Upon receipt of the approval document, the importer initiates the import transaction.
5. USAID/Zaire and the Department of Plan will notify the participating bank of any disapproval.
6. Importers will be made aware by the GOZ that any interpretation of the above procedures resulting from discussions between importers and USAID/Zaire staff can only be considered as a formal commitment when the participating bank has received in writing the joint confirmation of USAID/Zaire and the Department of Plan.

(3) Validation Of The Import License

After receiving the approval document and its attachment from USAID/Zaire, the participating bank will prepare and validate the import license.

(4) Payments To Suppliers

1. Payment By Letter Of Credit

- o As indicated in the approval documents and upon the importers' requests, participants' banks open irrevocable Letters of Credit to be confirmed by one of the eligible American Banks holding an AID/W Letter of Commitment and payable by such bank to the supplier. The American banks will accept the Letters of Credit relating to the eligible transactions opened by the "participating banks" when accompanied by a certification that the opening credit has been approved by USAID.

- o Participating banks should make complete references to the following in Letters of Credit:

  - the performance invoice or order (serial number + date)
  - the import license (bank code and serial number)
  - the approval document (transaction number)
  - the name of the American bank and the bank Letter of Commitment number mentioned in the approval document
  - The US Department of Commerce Schedule "B" codes

- o Copies of the Letters of Credit, Import License, performance invoices, and a copy of the loan agreement where applicable. Along with these documents should be sent a copy of the notice of transaction to be sent by the participating bank to the Fiduciary Bank.

- o Any amendment or change to a Letter of Credit is subject to USAID/Zaire's approval.

- o The payments provided for in the Letters of Credit will be made on presentation to the eligible American bank of the following documents, as specified in the Letters of Credit:

  - commercial invoices relating to commodities, transport and transport insurance, or documents in lieu thereof;

- transport documentation (bill of lading, airway bill, consignment note, etc.) issued "to the order of" the participating banks which opened the Letter of Credit (and to be notified to the importer);

- packing list;

- form 11 approved by AID/Washington. This will be required only when the supplier is American as was the case for CIP-AEPRP (660-0121) and is due to the fact that USAID will have previously approved the eligibility of the commodity.

- AID Form 282 (Supplier's Certificate);

- statement from the supplier certifying to his compliance with AID marking requirements as stipulated in AID Regulation 1;

- insurance certificate;

  Pre-Delivery Inspection Certificate issued at the time of loading by the persons or firms designated by USAID when the commodities are imported from a country other than the U.S.;

- any other document relating to any commodity which could be required by USAID/Zaire and the Department of Plan.

2. Payment By Direct Letters Of Commitment

o Direct Letters of Commitment (DL/Com) will be issued by USAID/Zaire with the agreement of the Department of Plan. The participating bank receives notification of this method of payment in the joint approval document from USAID/Zaire and the Department of Plan. A copy of each Direct Letter of Commitment will be given by USAID/Zaire to the participating bank concerned as well as to the importer. USAID will also notify the Fiduciary Bank of the issuance of the DL/COM.

o The Direct Letters of Commitment will state that the supplier must submit documents for payment to AID/Washington (M/SER/OP/CONS/M). The same documents will also be sent to USAID/Zaire. These documents are specified in 7.3(4)1. above.

  Note: When the supplier is a resident of an eligible country other than the U.S., AID Form 11 will not be required as was the case with CIP-AEPRP (660-0121). This is due to the fact that USAID will have previously approved the eligibility of the commodities.

o) USAID/Zaire will issue the Direct Letter of Commitment upon receipt from the participants bank of the copy of the validated import license. In addition, the participating bank will furnish USAID copies of all transmittals to the Fiduciary Bank identifying the transaction and depositing funds.

o) Each Direct Letter of Commitment will stipulate that the documents relating to shipment should be made "to the order of" the participating bank having validated the import license.

o) Any amendment or change in the DL/Com is to be made by USAID/Zaire.

## 7.4 Counterpart Fund

### (1) Constitution Of The Counterpart Fund (CPF)

- o The importer shall pay in zaires to the CPF the equivalent of foreign currency CIF (Cost, Insurance and Freight) value of the imported goods. This will be done through the importer's participating bank.

- o For imports by Letters of Credit, the equivalent amount should be calculated using the U.S. dollar buying rate of exchange published by the Bank of Zaire on the date of opening of the Letter of Credit.

- o For imports payable under a Direct Letter of Commitment, the equivalent amount should be calculated using the U.S. dollar buying rate of exchange published by the Bank of Zaire on the date of validation of the import license.

- o All payments in zaires to the Counterpart Fund shall be made at the same rate of exchange fixed at the opening of the letter of credit or the validation of the import license.

- o All the amounts shall be paid by each participating bank to the Fiduciary Bank on behalf of the Department of Plan/Secretariat of Counterpart Funds.

- o The payments shall be made by the importers to the participants banks which have opened Letters of Credit or validated the import licenses, and by such banks debiting the importer's account. These banks will, in turn, credit the amounts to the CPF account at the Fiduciary Bank on maturity through clearing. Copies of evidence of debiting the importer's bank's account and credit of funds (including interest) to the CPF account will be furnished to USAID.

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(2) Interest Rates and Banking Fees

- Based on the kinds of commodities to be financed, and on the nature of the importer's business, USAID will establish the maximum length of time for the importer to repay the CPF account (see Exhibit 7.1, Suggested Repayment Schedules). The participating bank will bear the credit risk towards the CPF since it must guarantee the importer's repayment by the end of the time allowed. The PSSP, by varying the maximum repayment time, will be able to offer incentives to importers to invest in capital goods. The term of the prescribed payment period will be calculated from the date the shipping documents are negotiated.

- For example, an MSE that wants to import a large machine as a capital investment will be allowed through its bank from one to three years (excluding the grace period) to repay the local currency equivalent of the foreign exchange. Importers bringing in raw materials or spare parts would receive up to twelve months credit. Finally, importers bringing in any kind of goods, raw materials, equipment, or spares for resale would also receive up to twelve months credit.

- At regular consultations with the GOZ, project authorities will set the interest rate on project funds lent to the private sector. The rate of interest will at least equal the prevailing rate of interest charged by commercial banks for short-term loans and will take into consideration projections of future inflation. Interest will accrue periodically to the outstanding balance of each loan and will be compound interest. The project may offer borrowers the option of capitalization of interest in early payments, to be reimbursed in later payments, in order to take account of the affects of inflation when multiple payments are called for in the loan agreement. This interest rate will remain fixed for all remaining payments. Interest charged will be collected by the participating bank from the borrower and paid entirely into the CPF account at Fiduciary Bank.

- The PSSP, provider of the foreign exchange, may choose to charge a foreign exchange commission which banks normally charge their customers at the opening of the letter of credit when the foreign exchange is provided by the banks.

(3) Payments To The Counterpart Fund

All payments will be made by the importer to the participating bank which will, in turn, forward payment to the Fiduciary Bank for deposit in the CPF account. It must be emphasized that the participating bank will be strictly held to its guarantee of the promissory note executed by the importer for repayment of the CPF.

1. For Commodities Shipped By Sea:

   o Under Letter of Credit: Upon opening of the Letter of Credit, the importer may make no minimum payment in zaires if the participating bank is willing to guarantee the full amount of the subsequent loan. Calculation of this equivalent amount in local currency will be based on the U.S. dollar buying rate of exchange published by the Bank of Zaire on the day of the opening of the Letter of Credit. The exchange rate so calculated will remain in effect for the life of the transaction.

   o Under a Direct Letter of Commitment: In case of payment to the supplier by a Direct Letter of Commitment, the importer may make no minimum payment in zaires if the participating bank is willing to guarantee the promissory note to be given by the importer for the full CPF amount to be repaid. The amount of interest to be repaid will be calculated using the U.S. dollar buying rate of exchange published by the Bank of Zaire on the date shipping documents are negotiated. The exchange rate so calculated will remain in effect for the entire transaction. At the same time, the importer will pay to the Counterpart Fund the equivalent in local currency of US $125.00 which is to cover private courier charge should the Direct Letter of Commitment be sent to a supplier outside the U.S.

   o Endorsement by the participating banks of ocean transportation documents is subordinated to the issuance of promissory notes referred to herein.

2. For Commodities Shipped By Other Means

These transactions present control problems since, unlike shipments made by sea, there is no workable system for endorsement or negotiation of airway bills or land waybills. For example, for goods coming by truck from the east there is no means for pre-delivery document clearance or negotiation by a bank in Kinshasa. Also, air shipments to Kinshasa do not lend themselves to airway bill negotiation. Consequently:

   o The period of promissory notes must be set according to the repayment schedule set by USAID/Zaire in the transaction approval document. In these cases, the maximum payment terms prescribed in Exhibit 7.1. will be applied based on the promised delivery date.

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- o For each payment made by the participating bank to the Fiduciary Bank, USAID/Zaire must receive copies of payments.

- o At the same time, the importer will pay to the Counterpart Fund the equivalent in local currency of $125.00 to cover private courier charge, if the Direct Letter of Commitment is to be sent to a supplier outside the U.S.

3. Promissory Notes

- o The period of promissory notes must be set according to the repayment schedule set by USAID/Zaire in the transaction approval document.

- o For each payment in zaires made by the participant bank to the CPF bank, USAID/Zaire must receive copies of payments.

- o The participating bank is responsible for furnishing the Fiduciary Bank information as to transaction status and issuance of promissory notes it has guaranteed. Each promissory note will be identified by the transaction number and account number of the importer but not the importer's name.

## 7.5 USAID Monitoring And Control

### (1) Participating Bank Reporting To USAID

A detailed discussion of the project monitoring and control system is included in Annex 5, Administrative Analysis, Section 5.7.

The participating bank will furnish USAID the following:

- o Copies of all letters of credit opened and amended.

- o Copies of importer issued promissory notes for payment to the participating bank for the CPF to show interest charged and schedules for payments. Copies of the transaction status report to the Fiduciary Bank will also be furnished to USAID.

- o Evidence of all deposits made to cover the foreign exchange cost of L/Cs and DL/COMs (if any).

- o A monthly report showing the status of all open L/Cs and DL/COMs in terms of commodities shipped and payment to the CPF. This will include transaction number, importer's

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account number and the terms of payment and interest charged. In reporting Letters of Credit, the pertinent AID-Washington Letter of Commitment will be cited. A copy of the report will be furnished to the Fiduciary Bank.

(2) Reports By The Fiduciary Bank To USAID.
(Copies will be furnished to each participating bank.)

- Monthly Outstanding L/C and DL/COM Reports: Indicates L/Cs and DL/COMs per bank, transaction number, commodities involved, L/C maturity or DL/COM expiration date, the value in dollars and zaires, and pertinent interest rates and exchange rates. The report should include a section covering guarantees called in from participating banks for importer default and the value and transaction number of each one.

- Monthly Delinquent Loan Report: Indicates overdue payments under L/Cs and DL/COMs broken down by bank and sector of activity, reasons for delinquency and age of overdue payments as well as the fact of payment (or non payment) by the participating bank in meeting its guarantee obligation. Delinquency is required to be reported whenever an importer misses a payment and regardless of whether or not the bank itself repays the CPF. In all such cases the transaction number and number of the importer's account will appear in the report. Recommendation for calling in the guarantees of participating banks will be made in each case of delinquent payments.

- A Brief Quarterly Analysis and Evaluation of the import program, describing presumed reasons for low or high rate of overdue payments under the PSSP program, any problems encountered in interacting with the participating banks and any recommendations to improve the system.

7.6 The PSSP Local Currency Lending Programs (LCLP)

(1) Eligible Participants

The small and medium size enterprises (MSEs) eligible to participate in the CIP component will also be eligible to obtain local currency financing under the PSSP's Local Currency Lending Program (LCLP). See 7.1(2). The eligible MSEs are those firms with no more than 500 employees and/or annual sales of no more than the equivalent of $5.0 million dollars. No exceptions will be made.

(2) Eligible Commodities

The LCLP will provide local currency financing for locally available raw materials, spare parts, equipment, machinery, trucks, and heavy equipment. The goods financed may be either imported or locally produced, but must be purchased locally. Thus, MSEs may obtain local currency financing to purchase goods imported for resale by other firms. Commodity-related services such as the installation of equipment locally purchased may also be financed.

The LCLP will also finance local agricultural buying campaigns for commodities such as coffee, tea, palm oil, quinine, corn, manioc, and cocoa.

No local currency from the LCLP may be lent by participating banks to borrowers to finance purchase foreign exchange.

(3) Source/Origin Of Commodities

The source/origin of commodities eligible for the LCLP will be AID Geographic Code 935. The LCLP may provide financing for locally available, or shelf-items, goods that are of Free World source and origin. This includes commodities that are grown, mined, produced, manufactured, or processed in Zaire.

(4) Eligible Amount Per Transaction

The minimum transaction to be authorized will be no less than the equivalent of $5,000. The maximum amount for a transaction will be determined by USAID and the GOZ depending on the market potential for local currency loans. The equivalent value in local currency will be calculated at the Bank of Zaire's exchange rate on the day the borrower's loan application is approved by the participating bank. The equivalent value, once calculated, will remain in force for the duration of the loan.

(5) Interest Rates And Banking Fees

Under the LCLP the MSE borrower will be obliged to repay interest on the loan equal to the market interest rate in effect at the time the loan is approved. The interest will be paid, along with the principal, to the CPF account at the Fiduciary Bank. As in the CIP component (see 7.11(2)), the LCLP will charge the borrower a fee in order to recover, to the maximum extent possible, the real value of the money loaned out. The borrower's payment of the commercial bank's guarantee and administrative fees will be kept separate from principal and interest payments due to the CPF account.

(6) Eligible Banks

All of the same private commercial banks listed in 7.1(9) will be eligible to participate in the LCLP, except the bank selected to act as the Fiduciary Bank. This is to avoid a possible conflict of interest between the lending and disbursing/collecting operations in the same bank.

(7) Local Currency Loan Disbursement Methods

Various possible methods of disbursing counterpart funds under the LCLP have been identified. These include: a) a Loan Guarantee Method wherein the CPF lends to a private sector borrower through its bank, and the bank guarantees the loan repayment to the CPF; b) an On-Lending System in which the participating bank borrows the CPF and on-lends these funds to the private sector borrower; and c) a Reimbursement Program, whereby the participating bank first extends the loan to the private sector borrower and then requests reimbursement from the CPF.

The latter two local currency lending methods have been rejected because the participating banks would in effect be borrowing from the CPF to relend to the MSE. Such loans would automatically be included in the credit ceilings imposed by the Central Bank on each participating bank.

Only under the Loan Guarantee method do CPF loans fall outside the participating bank's credit ceiling, as the CPF would lend directly to the MSE under the participating bank's guarantee. In effect, the bank would merely guarantee the obligation of its client. This is called a "signature credit" or contingent off-balance sheet liability. As such the bank's credit ceiling is not affected.

In order to avoid local currency lending that falls under their credit ceilings, all of the eligible banks have requested that the Loan Guarantee Method be used for the LCLP.

As in the dollar financing component, in the LCLP the participating bank will select the borrower, assume all credit risks, be responsible for collecting principal and interest payments, and remitting all payments to the Fiduciary Bank.

(8) Timing Of Local Currency Releases

USAID and the GOZ's Department of Plan will agree to set aside in a separate escrow account at the Fiduciary Bank the amount of CPF local currency deemed necessary to operate the LCLP for approximately six months. The escrow account will be replenished as needed to the extent authorized under the PSSP. Each additional allocation of local currency for the LCLP will be agreed upon jointly by USAID and the GOZ.

(9) Allocations To Participating Banks:

Participating banks will draw on the LCLP escrow account in the Fiduciary Bank on a first come, first served basis.

## 7.7 Incentives For Participating Banks To Increase MSE Clients

The fact that funds will be available on a first come, first served basis should be an incentive for participating banks to seek to increase their list of MSE clients and credit available to these companies.

## 7.8 Measures To Encourage Rapid Lending

USAID will require participating banks to submit monthly reports covering all loan activity under the LCLP. At the same time the Fiduciary Bank will publish a monthly report showing on a cumulative basis the amount of funds drawn down by each participating bank and the number of active MSE loan accounts. The Fiduciary Bank will distribute the report to all participating banks and to USAID. Thus, each participating bank will be able to compare its lending activities to that of the other banks.

## 7.9 LCLP Procedures

### (1) Request From Private Sector Borrower To A Participating Bank

The private sector borrower will make a request to its participating bank for a loan to purchase locally available goods or for an agricultural buying campaign. In the case of financing of goods the borrower will submit its loan request to the bank accompanied by the pro-forma invoice(s) for the goods and any related services. In the case of agricultural financing the borrower will submit a procurement plan with its loan request.

- <u>For Commodities and Related Services</u> The private sector borrower seeking to obtain local currency financing to purchase commodities will solicit quotations from as many suppliers as necessary. Solicitations for quotations should be made in such a way as to constitute a firm contract that can be financed under the LCLP. For this purpose the borrower will inform the supplier that the transactions must fulfill the objectives of the LCLP and conform to the Bank of Zaire Circular governing the LCLP, and that the goods must be of Free World Source and Origin.

- <u>For Agricultural Buying Campaign</u> The private sector borrower seeking local currency financing for an agricultural buying campaign will develop a <u>procurement plan</u> to submit to the participating bank. The plan will include the kinds of agricultural commodities to be purchased, the estimated quantity, estimated unit cost and total cost, approximate dates of the buying campaign, and the location where the commodities will initially be stored.

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(2) Verification And Approval Of Loan Applications By The Participating Bank

- o Upon receipt of a request from an MSE to borrow local currency from the LCLP, the participating bank will evaluate its client's loan application. The bank will review the application to determine if the transaction and commodities comply with the provisions of the pertinent Bank of Zaire Circular and the objectives and criteria of the LCLP. The bank will also set all loan terms and conditions with the borrower. As under the CIP, these terms will be based on the nature of the purchase.

- o After verifying and approving the loan application the participating bank will assign a transaction control number to the dossier, and remove the cover sheet with the name of the borrower. This will maintain the borrower's confidentiality, so that the Fiduciary Bank cannot gain information about the participating bank's clients.

(3) Disbursement By The Fiduciary Bank To Participating Banks

- o The participating bank will transmit the approved, numbered LCLP transaction sheet to the Fiduciary Bank, thus requesting release of the approved loan funds. The transaction sheet will include the details of the borrower's repayment schedule of principal and interest to the CPF bank. It will not, however, show the name of the borrower. The sheet will also constitute a guarantee of all payments by the participating bank to the CPF account. Copies of all such documents will be furnished to USAID.

- o The Fiduciary Bank will be required to release the loan funds in local currency to the participating bank within one working day from the time the request is made. Copies of such requests for transfer will be furnished to USAID. The Fiduciary Bank will debit its LCLP escrow account each time a transfer is made and will report such activity to USAID on a monthly basis.

(4) Release Of Loan Funds To The MSE Borrower

As soon as the participating bank receives the transfer of funds from the Fiduciary Bank, the participating bank will make one of the following payments:

- o In the case of commodities and related services, issue a check directly to the designated supplier.

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- In the case of an agricultural buying campaign, credit the borrower's account.

## 7.10 Counterpart Fund Account Repayments

The private sector borrower will pay in local currency to the CPF Account the total value of the local currency loan plus interest. The payments shall be made to the borrower's participating bank which has approved the loan application. The participating bank will, in turn, credit the CPF account at the Fiduciary Bank. The borrower will ensure payment of the principal and remaining interest in one of the following ways (see Exhibit 7.3).

- For Short-Term Credit (up to 12 months): The borrower will sign promissory notes in favor of the CPF showing the amount of principal and the maturity date. These promissory notes will be countersigned by the borrower's bank as guarantor. On maturity, the borrower's account will be debited by the participating bank to clear the note. The participating bank will, in turn, transfer the funds to the CPF account and adjust records to show the promissory note as paid.

- For Medium Term Credit up to 3 years: the borrower will sign a loan agreement with his bank establishing the loan amount, interest rate, the required collateral and the repayment schedule. The repayment will be the same as for short-term credit.

## 7.11 USAID Monitoring And Control

A detailed discussion of the project monitoring and control system is found in Annex 5, Administrative Analysis, Section 5.7.

### (1) Participating Bank Reporting

The participating bank will supply USAID with:

- Loan Application Files: a copy of each complete loan application file after the bank has approved the loan. The file will include the borrower's request for a loan, pro-forma invoices or procurement plans, the banker's loan approval and transaction number, repayment schedule of principal and interest, copies of paid invoices, and receiving reports for goods or warehouse receipts for agricultural commodities.

- Monthly Status Report on LCLP Account: Indicates the amount of local currency approved for loans by the participating bank, amount received from the Fiduciary

Bank to cover these loans, and the amount actually disbursed on each transaction. The report will identify each loan by the transaction number and the borrower's account number.

(2) Reporting By The Fiduciary Bank

The Fiduciary Bank will furnish USAID:

- Monthly LCLP Escrow Account Statement: Indicates the status of the CPF escrow account and related activities. Transfers into the escrow account from the regular CPF account will be shown with references to the USAID/GOZ authorization. Monthly and overall cumulative drawdowns against the LCLP escrow account per participating bank will be identified by pertinent transaction numbers and the borrowers' account numbers. Loan activities will be separated for each participating bank.

- Monthly Outstanding Loan Report: Indicates outstanding loans per bank and per sector of the borrowers' activity and loan tenor, maturity and interest rates. Loans will be identified by the transaction number and the borrower's account number.

- Monthly Delinquent Loan Report: Indicates overdue loans per bank and per sector of activity, reasons for delinquency and age of overdue loans. Required whenever a borrower misses a payment and regardless of whether the bank repays the CPF. Loans will be identified as in the monthly report.

- A Brief Quarterly Analysis/Evaluation of the loan program, describing the reasons for low or high rate of credit utilization under the PSSP program, problems encountered in interacting with the participating banks, and recommendations to improve the system.

Detailed Procedures And Monitoring Control Points For Private Sector Financing Activities

1. Foreign Exchange Transaction Approval Procedure

Step 1: MSE requests for FX financing includes proformas and selection.

Step 2: Participating bank reviews importer's request for importer's eligibility as MSE, credit risk, compliance with USAID/GOZ instructions commodity eligibility and end-use. May approve or disapprove. If approves, prepares cover letter to USAID recommending approval and CPF repayment schedule.

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Step 3: USAID reviews for importer and commodity eligibility and proposed end-use, compliance with all regulations and repayment plan. If approves prepares approval letter for joint USAID/GOZ signature. Sends letter and file to GOZ for signature which usually the same day.)

Step 4: GOZ clears transaction in light of overall GOZ policy. Co-signs and returns letter and file to USAID. (Note: For CIPS 0100, 0103 and 0121 GOZ has not disapproved an transaction approved by USAID.

Step 5: USAID forwards co-signed letter to participating bank with information copy to importer. Files in transaction file.

Step 6: USAID prepares "Approval Summary Notice" and send to Fiduciary Bank. Importer's name is not shown.

Step 7: Participating bank contacts importer and arranges for transaction to be undertaken as approved.

Step 8: MSE receives information copy of approval letter and contacts bank if bank has not already contacted him.

Step 9: Fiduciary Bank, upon receipt of the "Approval Summary Notice", sets up control data to monitor the repayment to the CPF account as transaction progresses.

Monitoring Control Points

Step 2: Participating bank establishes suspense on reply from USAID regarding approval (or disapproval) or request.

Step 3: USAID review and approval or disapproval. If approved, establishment of suspense on GOZ requested action.

Step 4: Policy compliance review by GOZ.

Step 6: "Approval Summary Notice" furnished to Fiduciary Bank for establishment of controls on subsequent CPF payments by participating bank.

2. Opening Of Letter Of Credit Procedure

Step 1: MSE requests Letter of Credit (L/C) to be opened based USAID/GOZ approval.

Step 2: Participating bank sends USAID drafts of L/C and import license.

Step 3: USAID reviews drafts. Pulls copies for control file. Approves or disapproves.

Step 4: Participating bank, after validating import license, opens L/C, prepares transaction summary and sends to Fiduciary Bank. Sends validated import license and copy of L/C to importer.

Step 5: U.S. Bank confirms L/C to supplier.

Step 6: Supplier proceeds to delivery goods.

Step 7: Fiduciary Bank posts transaction control file established when transaction was approved.

Step 8: Supplier ships goods, distributes documents and claims payment from US bank.

Step 9: Participating bank endorses (negotiates) documents to importer per agreements and forwards endorsed Promissory Note to the Fiduciary Bank.

Step 10: Importer clears goods through customs using all documents received.

Step 11: After receipt of documents US bank pays supplier.

Step 12: U.S. bank claims reimbursement from AID under L/COM.

Step 13: AID reimburses U.S. bank.

Step 14: Supplier submits Receiving Report to USAID.

Step 15: USAID receives Receiving Report and schedules end-use check.

Step 16: U.S. Bank submits L/C status report to the Fiduciary Bank. (Report required by USAID.)

Step 17: Fiduciary Bank uses report to follow-up on participating bank and reconcile records.

Step 18: Participating bank submits monthly report to Fiduciary Bank.

Step 19: Fiduciary Bank analyses report for indicated action.

Step 20: Fiduciary Bank uses report for reconciliation and follow-up

Step 21: Fiduciary Bank submits monthly and quarterly reports to USAID

Step 22: Fiduciary Bank analyses report for indicated action.

Step 23: Participating bank uses copy for corrective action or reconciliation.

Monitoring Control Points

See steps as follows: 3, 7, 11, 17, 19, 20, 22, and 23.

3. Issuance Of USAID Direct Letter Of Commitment

Step 1: Importer, upon receipt of copy of approval letter advising DL/COM will be issued, requests the participating bank to validate the import license.

Step 2: Bank acts on basis of USAID/GOZ approval letter to validate the import license, take any required CPF payment. The bank then prepares a "transaction summary" to the Fiduciary Bank with all information as to the transaction, and schedule of CPF payments.

Step 3: USAID, upon receiving the "transaction summary" and certification of guarantee, issued the DL/COM. The original is sent to the supplier and copies to importer and bank.

Step 4: The Fiduciary Bank updates its transaction control file for follow-up on CPF repayment.

Step 5: Supplier ships the goods, bills AID/W and sends shipping documents to the bank (for endorsement to the importer) and copies USAID, AID/W and the importer.

Step 6: AID/W pays the supplier.

Step 7: Bank negotiates (endorses) the shipping document to the importer per agreement.

Step 8: Fiduciary Bank updates transaction control file for follow-up for receiving report and CPF payment.

Step 9: Importer clears goods and sends receiving report to the participating bank.

Step 10: Posts receiving report and sets up end-use check.

Step 11: Participating bank submits monthly report to Fiduciary Bank.

Step 12: Fiduciary Bank analyses report for indicated action.

Step 13: Fiduciary Bank uses report for reconciliation and follow-up.

Step 14: Fiduciary Bank submits monthly and quarterly reports to USAID

Step 15: USAID analyses report for indicated action.

Step 16: Participating bank uses copy for corrective action or reconciliation.

Monitoring Control Points

See steps as follows: 3, 4, 8, 10, 12, 13, 15 and 16.

4. Payments To The Counterpart Fund Account Procedure

Step 1: Importer authorizes bank to debit his account and repay CPF according to agreement. This procedure (Step 1-5) repeats for each repayment.

Step 2: On maturity bank debits MSE's account.

Step 3: Participating bank deposits the CPF repayment made by the MSE to the CPF account at the Fiduciary Bank.

Step 4: Fiduciary Bank credits payment by the participating bank and updates status of repayment against the transaction in its status control file.

Step 5: Participating bank prepares monthly report to the Fiduciary Bank.

Step 6: Fiduciary Bank receives report, updates control records and initiates indicated action.

Step 7: Fiduciary Bank reviews local bank report and reconciles with records of transaction status.

Step 8: Fiduciary Bank prepares required reports and submits them to USAID with copy to all participating banks. Cut off dates can be adjusted to permit reports from participating banks to be useful as feeder information to the Fiduciary Bank.

Step 9: Audit firm reconciles Fiduciary Bank report with reports from local banks and holds periodic discussions to resolve discrepancies.

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Step 10: Local bank seeks to trace discrepancies reported by Fiduciary Bank. USAID may coordinate.

Step 11: Fiduciary bank reports to GOZ Department of Plan as required.

Step 12: GOZ may want to know USAID's position depending on report from the Fiduciary Bank.

Step 13: USAID briefs GOZ as necessary.

Monitoring Control Points

See steps as follows: 2, 3, 4, 6, 7, 9, 10, 11, and 12.

5. Local Currency Lending Program (LCLP) Procedure

Step 1: Borrower submits local currency loan request, including quotations for goods or procurement plan for agricultural buying campaign.

Step 2: Participating bank reviews and approves loan request. Determines credit risk. Establishes principal and interest payment schedule. Has borrower execute Promissory Note which participating bank guarantees. Returns documents.

Step 3: Fiduciary Bank receives copies of documents processed by participating bank. Establishes transaction control file to follow-up on use of proceeds and end-use.

Step 4: Participating Bank assigns transaction control number and prepares transaction sheet to be sent to the Fiduciary Bank. Sheet includes details of loan, purpose and repayment schedule and participating bank's guarantee of repayment. Sheet requests release of fund from CPF escrow account to cover loan. Participating bank transmits sheet to the Fiduciary Bank with signed information copy to USAID.

Step 5: Fiduciary Bank processes participating bank's request for release of funds within one working day.

Step 6: Fiduciary Bank debits CPF escrow account and transfers funds to participating bank for stipulated use.

Step 7: Fiduciary bank updates transaction control file established in Step 3.

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Step 8: Participating bank does following with funds received from participating bank in Step 6.

Case A) For commodities and related services, issues check directly to supplier and debits borrowers account. Informs borrower.

Case B) For agricultural buying campaign, deposits funds in borrower's account and notifies borrower.

Note: The participating bank establishes and indebtedness against the borrower's account. Repayments are made according to the terms of the short or medium-term credit, maturity date of Promissory Note or terms of the loan agreement.

Step 9: Borrower submits to participating bank evidence of proper use of funds such as paid invoices, receiving reports for goods or warehouse receipts for agricultural commodities.

Step 10: Participating bank reviews documents to verify proper utilization of loan funds. Sends copies to USAID.

Step 11: Fiduciary Bank notes documents, questions participating bank when indicated and updates transaction control file.

Step 12: Borrower authorizes repayment of loan from his account per agreement.

Step 13: Participating bank debits borrower's account and transfers funds to participating bank for CPF account. Adjusts records and status report data to be submitted to USAID.

Step 14: Fiduciary Bank credits the CPF escrow account and updates control records.

Note: Steps 12 through 14 will be repeated until loan is fully repaid.

Step 15: Participating bank monthly status report of loan funds to USAID with information to Fiduciary Bank.

Step 16: Fiduciary Bank updates transaction control file. As indicated, USAID may ask audit firm to review records at participating and Fiduciary Banks, aside from regular audit.

Step 17: Fiduciary Bank reconciles participating bank's report with its records. Initiates needed action.

Step 18: Fiduciary bank submits a monthly report to USAID, with information to participating bank, on status of the CPF-LCLP escrow account, including monthly and cumulative draw-downs by participating bank. Thus each participating bank will see activity of other banks.

Step 19: USAID receives copy of Fiduciary Bank report, updates files and initiates any indicated action to include asking audit firm for special audit.

Step 20: Participating bank receives copy of Fiduciary Bank report and will hopefully be motivated when comparing its activity with other participating banks.

Step 21: Fiduciary Bank furnishes to USAID monthly Loan Status Report with information to each participating bank. Report will be by participating bank and will include information as to schedule of repayments for current loans, value of closed loans and loans that are overdue. (The Fiduciary bank will separately advise USAID of action being taken to call in participating banks guarantees for defaulted loans.)

Step 22: USAID will post records, take indicated action, including request audit.

Step 23: Participating bank will seek to reconcile records with Fiduciary Bank if discrepancy exists and should be motivated to improve performance.

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## Exhibit 7.1

### Suggested CPF Repayment Schedules

- The collateral required at the opening of L/C or validation of import license (for a DL/COM) will be determined by the opening bank.

- The full amount of the loan must be covered by a promissory note and must be guaranteed by the opening bank.

- The repayment periods shown below for the various categories of commodities establish the final date for payment and begin on the day the Letter of Credit is opened or the Import License is validated for sea shipments, or the date established by the participating bank for shipments by other means (air, road, rail) (see 7.2(2)).

| Type import<br><br>End use of import | Raw materials | Small eqpt/machinery spare parts (unit cost less than $40,000) | Capital Goods for plant and operations expansion (e.g. Eqpt/Machinery heavy eqpt). |
|---|---|---|---|
| Importer's own use | Full payment within 9 months | Full payment within 12 months | Full payment within 36 months not including a grace period |
| Resale | Full payment within 9 months | Full payment within 9 months | Full payment upon sale and nc more than 12 months |

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## Exhibit 7.2.

### Sample Eligibility List of Commodities

| Agriculture | Agro-industry | General Industry | Construction | Transport |
|---|---|---|---|---|
| - Soybean meal | - Food processing eqpt (e.g. coffee tea, palm oil) | - Eqpt/Machinery | - Materials (rebar, glass, plastic, ceramics roofing, pipe, etc.) | - Trucks |
| - Animal vaccines | - Canning, packing eqpt/machinery | - Spare parts | - Eqpt./Machinery | - Spare parts |
| - Fertilizer | - Raw materials for canning, packing (paper, plastic, tinplate, jute) | - Materials (textiles, thread, yarn, chemicals, paper) | - Spare Parts | - Road construction maintenance eqpt |
| - Farm eqpt | - Raw materials for processing agricultural products (e.g. caustic soda) | - Computers | - Steel, iron | - Fuel, oil, lubricants |
| - Palm plantation eqpt | - Spare parts | - Communications eqpt | | - Buses |
| - Irrigation eqpt | - Marine engines | | | |
| - Animal ranching supplies, eqpt | - Fishing eqpt. | | | |
| - Seeds | - Forestry eqpt | | | |

Excluded goods

- Anything related to beer/soft drink industry
- " " " pharmaceuticals
- " " " pesticides
- Luxury goods (cosmetics, jewelry, etc.) or finished goods (textiles, shoes, appliances, electronics, etc.)
- Surplus/used/rebuilt items
- Military goods/Police-law enforcement eqpt
- Surveillance eqpt
- Weather modification eqpt.
- Hospital/Clinic eqpt/supplies
- Educational goods
- Restaurant eqpt

# Exhibit 7.3

## Counterpart Fund Repayments for Local Currency Lending

| Type of Local Purchase | Credit Terms |
|---|---|
| 1) Raw Materials for transformation into goods for resale<br>OR<br>2) Any purchase total value less than $20,000 | - Repayment of total principal and interest within 90 days |
| 3) Any purchase Total value between $20,000 and $60,000<br>OR<br>4) All agricultural buying campaign financing | - Repayment of total principal and interest within 180 days |
| 5) Heavy equipment/machinery | - Repayment of total principal and interest up to 3 years not including the grace period |

ANNEX 8

DETAILED BUDGET AND COST ESTIMATES

\- PRIVATE SECTOR SUPPORT PROJECT -

## 8.1 Introduction

This Annex details the financial flow, budget and cost estimates for the PSSP. The first section discusses disbursement of funds and cash flows, including a table which summarizes project costs. Methods of financing and financial accounting mechanisms are delineated in the following sections. The last section provides detailed budget and cost estimates, including project management costs, cash flow estimates, credit terms for foreign exchange lending, and estimates of local currency availability to the Counterpart Fund from the Foreign Currency Lending Program.

## 8.2 Disbursement Schedule And Financial Flow Estimates

The PSSP finances a $40 million grant from AID for quick disbursing balance of payments support to the GOZ. Approximately $35 million of this amount will be utilized over a three year period for specified essential private sector imports utilizing credit arranged by participating local commercial banks in a Commodity Import Program format. The balance of $5 million will be employed over a five year LOP for essential project management, technical assistance, audit fees, and special project studies and evaluations. No dollar funds will be made directly available to, or pass through, any GOZ organizations, including the Bank of Zaire.

The Mission plans to obligate $16,000,000 in the second quarter of FY 1989, $16,000,000 in FY 1990, $7,000,000 in in FY 1991, and $1,000,000 in FY 1992. In addition, the GOZ will contribute the local currency equivalent of $15 million for deposit to the CPF. These local currency contributions will come from funds currently being generated by other U.S. financed CIPs and PL 480 programs.

The PSSP will generate the local currency equivalent of $35.0 million collected by participating commercial banks from repayments of private sector businesses qualifying for the dollar foreign exchange commodity import program. These recoveries will be paid directly into the Mission's Local Currency Counterpart Fund (CPF) via a private local Fiduciary Bank under contract to USAID.

The local currency counterpart fund generations from the PSSP's dollar commodity import program and the GOZ contributions will be jointly programmed under normal Mission CPF programming and budgeting policies and procedures. Earmarks will be made annually or as required for the PSSP's Local Currency Lending Program (LCLP) and for incentive programs currently under study for encouraging the banking sector to mobilize local currency deposits and expand local currency lending to the private sector utilizing its own internally generated resources.

Reflows from local currency loans will return to the general U.S./Zaire CPF. Although further CPF contributions to the PSSP may be made in future years, reflows are not specifically earmarked for the PSSP.

See Exhibit 8.1, Summary Cost Estimate and Financial Plan, which follows this page for a summary of the source and application of funds.

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EXHIBIT 8.1

SUMMARY COST ESTIMATE AND FINANCIAL PLAN

- PRIVATE SECTOR SUPPORT PROJECT -

($000)

| SOURCE<br>APPLICATION | METHOD OF FINANCING | USAID $ | GOZ* $ | TOTAL |
|---|---|---|---|---|
| 1. COMMODITY IMPORT ($) LENDING (Z) | BANK L/COM<br>DIRECT L/COM | $35,000 | --- | $35,000 |
| 2. LOCAL CURRENCY LENDING | BANK LOAN | --- | 13,500 | 13,500 |
| 3. PROJECT MANAGEMENT 15 P/Y PSC PLUS LOCAL HIRE STAFF | DIRECT PAY | 3,400 | 500 | 3,900 |
| 4. TA - POLICY REFORM/ MONITORING/STUDIES 70 P/M | DIRECT PAY | 950 | 500 | 1,450 |
| 5. FIDUCIARY BANK SERVICES | DIRECT PAY | 250 | 500 | 750 |
| 6. AUDITS | DIRECT PAY | 200 | - | 200 |
| 7. EVALUATION | DIRECT PAY | 200 | - | 200 |
| TOTAL | | $40,000 | $15,000 | $55,000 |

* Equivalent in Local Currency

8.3 Methods Of Financing

Dollars will be disbursed directly to exporters by U.S. banks selected by project management. These banks will be reimbursed by the United States Government under Bank Letters of Commitment. Alternatively, Direct Letters of Commitment will be issued by USAID directly to suppliers/exporters in developing countries (as appropriate). The procedures, approval authorities, communication channels and reporting and control mechanisms for establishing Letters of Credit and insuring payments to suppliers are currently in place and working successfully as part of current Mission CIP programs. Consult Annex 7, Implementation Procedures for Private Sector Financing for further details.

Personal Services Contracts and institutional AID contracts will be used to procure technical assistance and consulting, fiduciary and audit services. Normal competitive bidding practices will be followed in qualifying, awarding and contracting.

8.4 Financial Accounting Mechanisms

Disbursement, recovery and accounting of local currency counterpart funds used for local currency lending or bank incentive programs will be based on CPF allocations to the PSSP for such activities as authorized by the Mission as part of normal CPF budgeting and approval policies and procedures. The designated Fiduciary Bank will maintain the Counterpart Fund account. The Fiduciary Bank will be responsible for disbursement, collection, accounting and reporting for these funds on the basis of USAID policies, procedures and approval authorities and under terms of specific contractual agreements between the bank and USAID.

Personal services contracts will be negotiated with individuals selected for the PSSP Project Management Unit. The USAID Controller will arrange direct payment. Short term technical assistance obtained from institutional contractors will be paid in the same manner.

Contracts for specific services or consulting assignments - impact studies, policy surveys, program research and analysis, audits, monitoring, evaluation and fiduciary bank services - will be competitively tendered against specific work scopes, schedules and performance criteria prepared by the PSSP Project Management Unit. Payments will be made as appropriate from dollar or local currency funds by the USAID Controller against invoices approved by the Project Design and Operations Office (PDO) and the Controller.

Exhibit 8.2, Projections Of Expenditures By Fiscal Year, which follows, shows forecast expenditures by year and by major expenditure category.

EXHIBIT 8.2

PROJECTIONS OF EXPENDITURES BY FISCAL YEAR

- PRIVATE SECTOR SUPPORT PROJECT -

TABLE I

($000)

| EXPENDITURES | YR 1 | YR 2 | YR 3 | YR 4 | YR 5 | TOTAL |
|---|---|---|---|---|---|---|
| USAID | | | | | | |
| 1. IMPORT FINANCING | $14,000 | $15,000 | $ 6,000 | - | - | $35,000 |
| 2. PROJECT MANAGEMENT | 600 | 650 | 660 | 740 | 750 | 3,400 |
| 3. TECH ASSIST/STUDIES | 185 | 245 | 205 | 175 | 140 | 950 |
| 4. FIDUCIARY BANK | 50 | 50 | 50 | 50 | 50 | 250 |
| 5. AUDITS | 40 | 40 | 40 | 40 | 40 | 200 |
| 6. EVALUATIONS | - | 50 | 75 | - | 75 | 200 |
| SUB TOTAL USAID | $14,875 | $16,035 | $ 7,030 | $ 1,005 | $ 1,055 | $40,000 |
| GOZ* | | | | | | |
| 1. LOCAL CURRENCY LENDING | $ 1,500 | $ 3,000 | $ 3,500 | $ 4,000 | $ 1,500 | $13,500 |
| 2. PROJECT MANAGEMENT | 100 | 100 | 100 | 100 | 100 | 500 |
| 3. TECH ASSIST/STUDIES | 100 | 100 | 100 | 100 | 100 | 500 |
| 4. FIDUCIARY BANK | 100 | 100 | 100 | 100 | 100 | 500 |
| SUB TOTAL GOZ | $ 1,800 | $ 3,300 | $ 3,800 | $ 4,300 | $ 1,800 | $15,000 |
| TOTAL PSSP | $16,675 | $19,335 | $10,830 | $ 5,305 | $ 2,855 | $55,000 |

*DOLLAR EQUIVALENT

8.5 Detailed Budget And Cost Estimates

This section provides more details and specialized tables on (1) estimates of project management costs, (2) cash flow estimates, and (3) local currency availability to the Counterpart Fund.

(1) Estimates Of Project Management Costs

Project management, technical assistance, fiduciary and audit fees and evaluation costs are estimated at $5.0 million over the five year LOP. Staffing, work content, and schedules for the conduct of this work are described in Annex 5, The Administrative Analysis and Annex 7, Implementation Procedures For Private Sector Financing.

- Project Management

  Project management costs were estimated on the basis of organizational structure and staffing levels of the PMU as described in Annex 5, Administrative Analysis. The five year LOP estimate is $3.4 million most of which will be disbursed under terms of individual PSC contracts paid by the USAID Controller. See Exhibit 8.3 for details of these project management costs.

- Monitoring And Technical Assistance

  Monitoring, technical assistance and impact survey services will be contracted on a competitive basis. Budgets were forecast on the basis of preliminary estimates of person months of services required. Consult Annex 6, Proposed Research, Evaluation And Impact Studies, for initial study, summaries and estimated costs.

- Fiduciary Bank And Audit Services

  Successful performance of these services require that contractors have some physical presence in Zaire. Fiduciary bank services will require a local bank with sufficient accounting and reporting capabilities. Payments for services rendered will be made on the basis of approved invoices submitted by the contracting company in accordance with contractual arrangements, and paid in local currency and/or dollars as appropriate by the USAID Controller.

(2) Cash Flow Estimates

An estimate of reflows to the local currency counterpart fund from the dollar disbursements was made using the following assumptions.

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Exhibit 8.3

PROJECT MANAGEMENT COSTS[1]

Table I

| | YEAR | | | | |
|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| Computers | 10,000 | --- | --- | --- | --- |
| Office Equipment | 10,000 | --- | --- | --- | --- |
| Office Supplies | 5,000 | 5,350 | 5,724 | 6,425 | 6,554 |
| Personnel | 566,399[2] | 606,046 | 648,470 | 693,863 | 742,433 |
| Travel | --- | 15,000 | --- | 17,000 | --- |
| Tech. Training Local Hires | --- | 15,000 | ---- | 17,000 | --- |
| TOTAL | 591,399 | 641,396 | 654,194 | 734,288 | 748,987 |

1. Seven percent inflation in office supply costs and personnel salaries a:
2. Total estimated personnel costs from Exhibit 2.2, Table 2

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Exhibit 8.3
DETAILED PROJECT MANAGEMENT COSTS
PERSONNEL COSTS

Table II

| | | PROG ECON | PROJ MANAGER | FINANCIAL SECTOR ECONOMIST |
|---|---|---|---|---|
| 1 | Compensation | | | |
| | GS 13/4, 16/3, FS1 Max. | 43,452 | 68,691 | 71,377 |
| 2 | Differential | | | |
| | 20% of Base | 8,690 | 13,738 | 14,275 |
| 3 | Allowances | | | |
| | Post 15% up to cap | 2,160 | 4,020 | 4,155 |
| | Educational 1/ | --- | 14,000 | 14,000 |
| | Educational Travel 1/ | --- | (7,200) | (7,200) |
| 4 | Travel | | | |
| | Res/Kin/Res | 3,600 | 14,400 | 14,400 |
| | R&R or HL | 2,700 | 10,800 | 10,800 |
| | Medevac | 1,250 | 5,000 | 5,000 |
| | Per Diem | 300 | 1,200 | 1,200 |
| 5 | Transportation (to post) | | | |
| | Shipment of HHE (7,200) | 10,800 | 10,800 | 10,800 |
| | Storage of HEE | 1,000 | 3,000 | 3,000 |
| | UAB | 625 | 1,750 | 1,750 |
| | POV | 3,000 | 3,000 | 3,000 |
| 6 | Other Direct Costs | | | |
| | Health Ins. NTE | 583 | 1,298 | 1,298 |
| | Life Ins. NTE | 500 | 500 | 500 |
| | SOS Ins. | 115 | 460 | 460 |
| | Physical Exam. | 200 | 560 | 560 |
| | Misc. (Passport, Visas, Innoculations) | 50 | 200 | 200 |
| | Housing and Utilities | 30,000 | 30,000 | 30,000 |
| | FAAS Charges | 17,000 | 17,000 | 17,000 |
| 7 | FICA (.0751) | 3,560 | 6,190 | 6,432 |
| TOTAL ESTIMATED COSTS | | 129,585 | 206,607 | 210,207 |
| TOTAL PERSONNEL | | | | 546,399 |
| CONTINGENCY | | | | 20,000 |
| | | | | 566,399 |

1. Higher of two optional allowances used for budgeting purposes. Assumes two school-age children.

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- o Dollar drawdowns would be made in three annual amounts of \$16,000,000, \$15,000,000, and \$6,000,000 respectively, for the commodity import program.

- o Repayment of local currency equivalent would be made under three repayment based on the nature of the commodities and the bank's evaluation of the importer/borrower's credit risk. (See Exhibit 8.4, Table II.)

- o Inflation over the period considered is assumed to depreciate against the dollar at rates equivalent to local inflation, consequently eroding the real value (also dollar value) of the counterpart fund.

- o The exchange rate of the loan is the commercial buying rate in effect at the time the loan is booked.

- o Interest will be paid to the Counterpart Fund on the dollar loans to the banks, in zaires, at market rates, estimated here at between 35 and 45 percent.

- o Funds are available to the Counterpart Fund from local participating banks upon repayment of dollar term loans by local creditors in zaires.

- o Local currency recoveries would begin in program year one and be completed in year six.

Cash flow forecasts, based on payment assumption terms under the three repayment programs, and local currency reflow payments in real and nominal dollar equivalents, are illustrated in Exhibit 8.4, Table III. Further details on the workings of the Counterpart Fund, reflows and Central Bank conditions are to be found in Annex 2, The Technical Analysis.

Table III of Exhibit 8.4 shows a small loss in real value or dollar equivalent value of the Counterpart Fund after five years. Under actual conditions the mission will program Counterpart Funds to avoid the erosive effects of inflation, using these funds as rapidly as possible for project support, and local currency lending. For this reason we have left the programming of PSSP Counterpart Funds in the out years flexible. Counterpart Fund management to allow for placement of the funds in six month Treasury bills has been negotiated with the GOZ. Careful use of these techniques should allow the Mission to reduce losses considerably as these bills are currently paying 40 percent interest.

EXHIBIT 8.4

CASH FLOW FORECASTS

- PRIVATE SECTOR SUPPORT PROJECT -

FOREIGN EXCHANGE DRAWDOWNS ($ 000)

TABLE I

| DOLLAR BALANCE | DISBURSEMENTS - YEAR 1 | 2 | 3 | 4 | 5 | TOTAL |
|---|---|---|---|---|---|---|
| 35,000 | 14,000 | | | | | 14,000 |
| 21,000 | | 15,000 | | | | 15,000 |
| 6,000 | | | 6,000 | | | 6,000 |
| TOTAL | 14,000 | 15,000 | 6,000 | | | 35,000 |

CREDIT TERMS FOR PRIVATE SECTOR FINANCING (FX)

| | | | |
|---|---|---|---|
| Type import<br>End use of import | Raw materials | Small eqpt/machinery spare parts (unit cost less than $40,000) | Capital Goods for plant and operations expansion (e.g. Eqpt/Machinery heavy eqpt). |
| Importer's own use | Full payment within 9 months | Full payment within 12 months | Full payment within 36 months not including a grace period |
| Resale | Full payment within 9 months | Full payment within 9 months | Full payment upon sale and no more than 12 months |

TABLE II

| PAYMENT TERMS | SHORT TERM 1<br>RAW MATERIALS | SHORT TERM 2<br>SPARE PARTS/<br>EQUIPMENT FOR RESALE | MEDIUM TERM 7<br>CAPITAL PLANT |
|---|---|---|---|
| | TOTAL PRINCIPAL<br>AND INTEREST<br>IN 90 DAYS | TOTAL PRINCIPAL<br>AND INTEREST<br>IN 180 DAYS | TOTAL PRINCIPAL<br>AND INTEREST<br>IN 1-3 YEARS |

EXHIBIT 8.4

TABLE III
LOCAL CURRENCY AVAILABILITY TO COUNTERPART FUND
FOR PRIVATE SECTOR FINANCING

($ 000 Equivalent)*

| | YEAR 1 | 2 | 3 | 4 | 5 | 6 | |
|---|---|---|---|---|---|---|---|
| 1. Loan Program | | | | | | | |
| ST1 | 4200 | 4500 | 1800 | | | | |
| ST2 | 4200 | 4500 | 1800 | | | | |
| MT1 | 2800 | 3000 | 1200 | | | | |
| MT2 | 1400 | 1500 | 600 | | | | |
| MT3 | 1400 | 1500 | 600 | | | | |
| Total CIP Funding | 14000 | 15000 | 6000 | | | | |
| 2. FX Rate Z/$ | 375 | 450 | 600 | 800 | 900 | 950 | |
| 3. Interest Rate | | 45% | 42% | 35% | | | |
| 4. Foreign Exchange Loss | | | | | | | |
| ST1 | (1159) | (321) | (129) | | | | |
| ST2 | (2317) | (643) | (257) | | | | |
| MT1 | | (3090) | (857) | (343) | | | |
| MT2 | | | (3234) | (1000) | (257) | | |
| MT3 | | | | (3717) | (1286) | (300) | |
| Total FX Loss | (3476) | (4054) | (4477) | (5060) | (1543) | (300) | (18910) |
| 5. Interest Gain | | | | | | | |
| ST1 | 473 | 473 | 158 | | | | |
| ST2 | 945 | 945 | 315 | | | | |
| MT1 | | 1260 | 1260 | 420 | | | |
| MT2 | | | 1423 | 1525 | 494 | | |
| MT3 | | | | 2868 | 2795 | 876 | |
| Total Interest | 1418 | 2678 | 3155 | 4813 | 3288 | 876 | 16228 |
| 6. Net Gain (loss) | (2058) | (1376) | (1322) | (247) | 1746 | 576 | (2682) |
| 7. Dollars Loaned to Recover | 8400 | 11800 | 8000 | 4100 | 2100 | 600 | 35000 |
| 8. Net CPF Position | 6342 | 10424 | 6678 | 3853 | 3846 | 1176 | 32318 |

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Exhibit 8.4, Table III Notes

Table III represents a simplified model of the CPF flows expected under the project. The most important assumptions made in this model are the following:

1. There will be five categories of foreign exchange loans made under the project. The terms of the five categories are the following:

   ST1 = 90 days short term
   ST2 = 180 days short term
   MT1 = 1 year medium term
   MT2 = 2 years medium term
   MT3 = 3 years medium term

2. All the loans will be repaid in zaires at an exchange rate determined by the commercial rate at the time the loan is made.

3. The loans will be made during the first three years of the project and will be paid back over a period of up to six years (depending on the category of each loan).

4. Interest will be paid on 100 percent of the dollars allocated.

Details of the other parts of the model by line item are the following:

Line 1: Is an estimate of the amount to be loaned by year for each of the five categories of loans.

Line 2: Is the estimated yearly average rates of exchange (in zaires per one dollar) over the life of the project. These estimates are based on a historical analysis of the zaire/dollar exchange rate.

Line 3: Is an estimate, by year, of the interest rates that will be charged by the project.

Line 4: Calculates, on the basis of the figures provided in lines 1-3, the foreign exchange losses to the CPF account for each category of loan by year of repayment.

Line 5: Calculates returns to the project CPF account from the interest charged by the project (Line 3). It is assumed that both the principal and interest are repaid in a lump sum at the maturity of the loan. It is further assumed that interest is compounded yearly.

Line 6: Calculates the net gain or loss to the project CPF account from the combined effect of foreign exchange losses and interest gains (Line 4 plus Line 5).

Line 7: Represents, for each year of the project, the dollar values of repayments on principal.

Line 8: Represents the net position of the CPF account at the end of each year of the project. This is calculated by taking the net gain or loss from interest payments and foreign exchange risk (Line 6) and adding the total of repayments on principle (Line 7).

ANNEX 9

PID AND PAAD APPROVAL MESSAGES

- PRIVATE SECTOR SUPPORT PROGRAM -

ACTION AID2 INFO AMB DCM ECON

VZCZCKI0293 12-FEB-88 TOR: 00:22
OO RUEHKI CN: 09410
DE RUEHC #3789/01 0430019 CHRG: AID
ZNR UUUUU ZZH DIST: AID
O 120014Z FEB 88 ADD:
FM SECSTATE WASHDC
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E.O. 12356: NA

RECEIVED FEB 16 1988 CIP

SUBJECT: ECPR GUIDANCE ZAIRE PRIVATE SCTOR SUPPORT PROJECT (660-0120)

1. ECP MET ON 28 JANUARY 1988 AND APPROVED THE PID FR SUBJECT PROJECT AT A LEVEL OF DOLS 40.3 MILLON. THE ECPR WAS CHAIRED BY DAA/AFR L. SAIERS AND INCLUDED REPRESENTATIVES FROM AFR/CCWA, PPC/WID, PPC/PDPR/RP, PRE/I, AFR/DP/PAE, AFR/DP/PAR, AFR/TR/ARD, AFR/PD, AFR/PD/CCWAP, GC/AFR, AFR/PRE, AS WELL AS USAID (B. ANDERSON AND J. RYAN). THE FOLLOWING GUIDANCE IS PROVIDED FOR MISSION ACTION DURING THE PP DESIGN.

2. POLICY FRAMEWORK AND CONDITIONALITY. BECAUSE OF THE IMPORTANCE OF THE BROADER ECONOMIC ENVIRONMENT TO THE PROJECT, THE PP SHOULD PRESENT A TIGHTLY ORGANIZED MACRO OVERVIEW AS A BACKDROP TO THE ACTIVITY. THIS SHOULD INCLUDE A DISCUSSION OF LINKAGES BETWEEN THE PROJECT AND THE NATIONAL POLICY FRAMEWORK, AN ANALYSIS OF GOZ COMMITMENT TO THE USAID AND NATIONAL REFORM AGENDAS AND A DESCRIPTION OF THE PROBABLE ROLE OF OTHER DONORS.

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BECAUSE OF THE IMPORTANCE OF THIS MACRO FRAMEWORK TO PROJECT SUCCESS, THE MISSION IS ENCOURAGED TO THINK IN TERMS OF SELECTED CONTINUING MACRO-ECONOMIC STANDARDS (EXCHANGE RATE, DEFICITS, TARIFF STRUCTURE, ETC.) AS COVENANTS TO THE FINAL AGREEMENT.

THE PP SHOULD DEVELOP AN AGREEMENT FRAMEWORK WHICH PROVIDES FOCUSED CONDITIONALITY CRITERIA OVER THE LIFE OF THE PROJECT. THIS FRAMEWORK MUST SPECIFY OBTAINABLE OBJECTIVES AND REALISTIC TIMEFRAMES FOR THEIR ACHIEVEMENT. THE PROJECT SHOULD BE REVIEWED ON AN ANNUAL BASIS TO DETERMINE WHAT HAS BEEN ACHIEVED.

3. FUNDING LEVELS. AN LOP FUNDING LEVEL OF DOLS. 40 MILLION WAS AUTHORIZED BY THE ECPR ON THE ASSUMPTION THAT CLEARLY MEASURABLE END OF PROJECT OBJECTIVES AND INTERIM BENCHMARKS CAN BE DELINEATED FOR THE PLANNED



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THREE YEARS OF OBLIGATION. BECAUSE OF THE NEED TO ADDRESS FAA SECTION 611 REQUIREMENTS, IN CALCULATING ITS FINAL PP FUNDING CONFIGURATIONS, THE MISSION WILL BE EXPECTED TO PLAN FOR PROJECT OBLIGATIONS ONLY IF THEY ARE ASSURED OF RAPID DISBURSEMENT. IF OUR UNDERSTANDING OF WHERE THE GOZ WANTS TO GO IN BANKING SECTOR REFORM DOES NOT ALLOW THE DEVELOPMENT OF MEDIUM TERM OBJECTIVES, THEN MISSION SHOULD CONSIDER LOWER FUNDING LEVELS AND A SHORTER LOP TIME FRAME. THUS, FINAL LOP LEVELS AND THE MANNER IN WHICH FUNDING IS ORGANIZED WILL VITALLY DEPEND ON THE OUTCOME OF PP ANALYSES AND THE DEGREE TO WHICH FUNDING RELEASE BENCHMARKS CAN BE MADE EXPLICIT.

4. BENEFICIARIES. THE PP MUST CLEARLY DEFINE THE EXPECTED TARGET GROUP INCLUDING GENDER, TYPE OF BUSINESS, ETHNIC BACKGROUND AND LOCATION. IT IS UNDERSTOOD THAT THE PROJECT WILL PROBABLY INITIALLY BENEFIT ONLY THE LARGER SME FIRMS THAT ARE ELIGIBLE FOR CREDIT. THE PP WILL BE EXPECTED TO ADDRESS THE WAYS IN WHICH THIS ACTIVITY WILL ULTIMATELY LEAD TO GREATER FOCUS ON THE LESS PRIVILEGED SMES IN THE MEDIUM AND LONG TERM. IF NECESSARY, THE MISSION SHOULD CONSIDER AUGMENTING THE TOR OF THE CURRENTLY PLANNED SME STUDY TO OBTAIN THIS INFORMATION.

ONCE IDENTIFIED, IT IS EXPECTED THAT THE PP WILL REVIEW THE EXPECTED IMPACT OF PROJECT CREDIT ON TARGET GROUP ACTIVITIES AND NOTE THE BEST CASE EXPECTATIONS OF CREDIT FUND IMPACT ON THE ZAIRIAN ECONOMY (E.G. CREATION OF JOBS, INCREASE OF GOODS AND SERVICES, ETC.)

THE ECPR DID NOT SUPPORT ESTABLISHING AN INCENTIVE INTEREST RATE FOR TARGET GROUPS. OPEN COMMUNICATION WITH PARTICIPATING BANKS AS WELL AS AN EFFECTIVE MONITORING SYSTEM SHOULD PROVIDE THE BASIS FOR DETERMINING HOW TO MOST EFFECTIVELY REACH THE TARGET BENEFICIARY GROUP. IF RELEVANT TARGET GROUPS ARE SYSTEMATICALLY EXCLUDED DURING THE EARLY STAGES OF IMPLEMENTATION, THE MISSION MAY THEN WANT TO LOOK INTO MORE INTRUSIVE FORMS OF TARGETTING AT THAT TIME.

5. WID. CLEARLY IT IS IN AGENCY AND CONGRESSIONAL INTERESTS TO SUPPORT THE INVOLVEMENT OF WOMEN IN THIS PROJECT. THE PP SHOULD EXPLICITLY ADDRESS HOW GENDER DISAGGREGATED DATA CAN BE GATHERED, ANALYZED AND MONITORED. IT WAS SUGGESTED THAT THE PROJECT PROVIDE LOCAL CURRENCY TO PVOS TO DO A STUDY SIMILAR TO THAT DONE BY COOPERS AND LYBRAND IN ORDER TO DETERMINE WAYS TO INTRODUCE WOMEN AS PART OF THE TARGET BENEFICIARY GROUP DURING PROJECT IMPLEMENTATION. ANOTHER ALTERNATIVE SUGGESTED WAS USING INDIGENOUS BUSINESS

SCHOOLS TO UNDERTAKE APPLIED RESEARCH IN THIS AREA.

6. DISBURSEMENT OF US DOLLARS 5 MILLION. THERE WILL BE NO FAST DISBURSEMENT AS ENVISAGED IN PID. ALL DISBURSEMENTS SHOULD BE MADE AS PART OF THE REGULAR PROJECT.

7. MONITORING PLAN. CONSIDERING THE RISKS INVOLVED WITH THIS PROJECT AND THE INCREASINGLY FELT NEED IN THE AGENCY TO MEASURE IMPLEMENTATION PERFORMANCE, THE MISSION NEEDS TO CAREFULLY DEFINE A MONITORING/EVALUATION PLAN WHICH PROVIDES ONGOING MANAGEMENT MONITORING IN RELATIONSHIP TO AVOWED PROJECT OBJECTIVES. IN THE EVENT THAT ANY OF THE PREVIOUSLY NOTED RISKS OF THE PROJECT BECAME REALITY, A MECHANISM FOR RAPID PROJECT READJUSTMENT SHOULD BE IDENTIFIED. QUANTITATIVE INDICATORS OF PERFORMANCE FOR ALL KEY ASPECTS OF THE PROJECT WILL BE REQUIRED.

8. DISRUPTION OF FOREIGN EXCHANGE RATES. IT WAS MUTUALLY AGREED BY AID/W AND MISSION REPRESENTATIVES THAT THE PROJECT SHOULD NOT DISBURSE FUNDS WHEN THERE IS A WIDE DISCREPANCY BETWEEN OFFICIAL AND PARALLEL FOREIGN EXCHANGE RATES.

9. CONCERN WAS EXPRESSED THAT IN THE ABSENCE OF CIP-TYPE CONTROL AS TO FINAL USE OF FUNDS, PP DEFINE MORE CAREFULLY THE ELIGIBILITY CRITERION FOR PRIVATE BANK LOANS UNDER THE PROJECT. SPECIFICALLY CONCERN WAS

EXPRESSED THAT TYPE OF COMMODITIES ELIGIBLE FOR IMPORT BE EXPLICITLY DEFINED SO THAT MANUFACTURING FIRMS COULD NOT USE THEIR ACCEPTED STATUS TO IMPORT UNACCEPTABLE COMMODITIES AS FINISHED PRODUCTS FOR TRADING PURPOSES SUCH AS PRODUCTS FOR LUXURY CONSUMPTION ETC.

10. LOCAL CURRENCY. THE ECPR DISCUSSED THE POSSIBILITY THAT LAGGED PAYMENT (ZAIRES) INTO THE COUNTERPART FUND MIGHT JEOPARDIZE ANY COUNTERPART PROGRAMMING SCHEDULES. THE MISSION INDICATED THAT REPAYMENT WAS NOT ON A LONGTERM DELAY BASIS (I.E. MOST PAYMENTS WOULD BE MADE IN SIX TO TWELVE MONTHS) AND THAT THE COMMERCIAL BANKS INVOLVED WOULD PAY ON SCHEDULE TO ASSURE THEIR FINANCIAL CREDIBILITY. AS A PORTION OF THE ZAIRES FLOWING INTO THE COUNTERPART FUND MIGHT BE PROGRAMMED AS STRUCTURAL ADJUSTMENT SUPPORT, ANY FLUCTUATIONS IN PAYMENT COULD BE ADJUSTED IN THAT AREA.



11. LEGAL CONCERNS. THE IEE IS APPROVED BUT ANY CHANGES IN PROJECT COMMODITIES OR ACTIVITIES MAY MAKE IT APPROPRIATE TO EXAMINE CATEGORICAL EXCLUSION AGAIN.

12. PP DELEGATION. GIVEN THE OVERALL MACRO-ECONOMIC ENVIRONMENT IN WHICH THIS PROJECT WILL TAKE PLACE, THE REFORM PROGRAM TO BE SUPPORTED, THE TARGETTING QUESTION AS NOTED ABOVE, AND THE NEED FOR FURTHER DEFINITION OF THE TECHNICAL ASPECTS OF THE LENDING PROGRAM, PROJECT PAPER APPROVAL OF A DOLS 40 MILLION ACTIVITY WILL REMAIN

IN AID/W. IF, HOWEVER, THE MISSION SHOULD DECIDE ON A MORE LIMITED ACTIVITY, AID/W WOULD CONSIDER DELEGATING FIELD AUTHORIZATION CONTINGENT UPON REVIEW AND APPROVAL OF POLICY REFORM PACKAGE. SHULTZ
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E.O. 12356: N/A

SUBJECT: ECPR GUIDANCE - ZAIRE PRIVATE SECTOR SUPPORT PROGRAM (660-0120)

1. THIS CABLE RECAPITULATES MAJOR ISSUES AND DECISIONS TAKEN AT ECPR FOR SUBJECT PROGRAM AND PROVIDES REVISIONS MADE BY MISSION REPRESENTATIVE BILL ANDERSON ACCORDING TO ECPR GUIDANCE.

2. ECPR MET ON 16 JUNE 1988 AND APPROVED PROGRAM AT A LEVEL OF DOLS 40.0 MILLION. OFFICES REPRESENTED AT THE ECPR INCLUDE AFR/PD, AFR/DP/PAB, PRE, AFR/DP/PAR, PPC/PB, PPC/PDPR/RP, REDSO/WCA, AFR/MDI, AFR/CCWA, GC/AFR, AND AFR/PD/CCWAP. ISSUES RAISED AT ECPR AND PROPOSED RESOLUTIONS ARE AS FOLLOWS:

A. ISSUE NO 1: PROJECT VS. NON-PROJECT ASSISTANCE

(1) NATURE OF ISSUE: LARGE CIP PORTION OF PROPOSED PROJECT SHOULD BE CONSIDERED AS DEVELOPMENT FUND FOR AFRICA (DFA) FUNDED NON-PROJECT ASSISTANCE. ALSO, BALANCE OF PAYMENTS SUPPORT RATIONALE AND OBJECTIVES UNDER DFA LEGISLATION MAY NOT BE USED.

(2) RESOLUTION OF ISSUE: PROGRAM RECAST AS COMBINED PROJECT/NON-PROJECT ASSISTANCE, WITH PAAD FACESHEET ADDED TO REFLECT CIP PORTION FOR DOLS. 35 MILLION AND PP FACESHEET CHANGED TO DOLS. 5 MILLION FOR TECHNICAL ASSISTANCE UNDER PROPOSED PROGRAM. ALL REFERENCES TO PROJECT CHANGED TO PROGRAM. ALL JUSTIFICATIONS OF CIP ON BASIS OF BALANCE OF PAYMENTS WILL BE DELETED. PROGRAM PURPOSE MODIFIED TO EMPHASIZE RESTRUCTURING OF COMMERCIAL BANKING SECTOR TO SUPPORT PRODUCTIVE INVESTMENT BY MEDIUM AND SMALLER-SCALE ENTERPRISES (MSES).

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B. ISSUE NO. 2: PROJECT GOAL AND PURPOSE PRESENTATION.

(1) NATURE OF ISSUE: GOAL LEVEL MUST BE MORE DEVELOPMENTALLY ORIENTED SHOWING LINKAGE TO CONCERNS

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WITH WHICH A.I.D. MORE TRADITIONALLY OPERATES.

(2) RESOLUTION OF ISSUE: IN THAT FINANCIAL SECTOR DEVELOPMENT POLICY (FSDP) STATEMENT WILL SERVE AS FRAMEWORK FOR PROGRAM, IT SHOULD BE AS CLEARLY DEFINED AS POSSIBLE. IT MUST LAY OUT WHAT IS EXPECTED AT THE END OF PROGRAM AS WELL AS SERVE AS FIRST CONDITION PRECEDENT BEFORE ANY PROGRAM FUNDS ARE RELEASED. INTERIM BENCHMARKS WILL ACT AS SUBSEQUENT CONDITIONS PRECEDENTS AS RELATED TO EXPECTED FINANCIAL SECTOR RESULTS. THOSE RESULTS EXPECTED FROM MACRO-ECONOMIC POLICY ISSUES SHOULD BE PRESENTED AS COVENANTS.

PAAD MODIFIED TO INCORPORATE CLEARER DEFINITION OF FSDP STATEMENT. STATEMENT SHALL EMBODY A LIBERAL, PRIVATE SECTOR-ORIENTED APPROACH TO FINANCIAL SECTOR REFORM AND DEVELOPMENT AND SHALL INCLUDE AS OBJECTIVES: TO PROMOTE COMMERCIAL BANK MOBILIZATION OF PRIVATE DOMESTIC FINANCIAL RESOURCES; TO FOSTER A MORE ACTIVE MONEY MARKET AND INTEREST RATES REPRESENTATIVE OF REAL ECONOMIC COST OF FUNDS; AND TO INCREASE AMOUNT OF CREDIT AVAILABLE TO PRIVATE ENTERPRISES. THE SPECIFIC OBJECTIVES TO BE WOVEN INTO STATEMENT ARE:

- BY END OF FIVE YEAR PROGRAM, REAL FINANCIAL RESOURCES MOBILIZED BY PRIVATE COMMERCIAL BANKS SHOULD BE GROWING BY AT LEAST 4 PERCENT PER YEAR.

- INTEREST RATES SHOULD BE POSITIVE RELATIVE TO INFLATION.

- COMMERCIAL BANKS SHOULD BE FINANCING A WIDER RANGE OF ENTERPRISES THAN BEFORE THE PROGRAM IN TERMS OF SIZE,

SECTOR OF ACTIVITY, AND GEOGRAPHIC AREA.

- GOZ BUDGET DEFICIT SHOULD BE FINANCED FROM MARKET AT MARKET DETERMINED RATES OF INTEREST.

- NO GOZ CONSTRAINTS SHOULD REMAIN ON BANK INTEREST RATES OR FEE STRUCTURES.

- REQUIRED RESERVES SHOULD BE SET AT MINIMUM LEVELS NECESSARY FOR STABILITY AND EFFICIENT GROWTH OF BANKING SYSTEM

- REQUIRED RESERVE DEPOSITS SHOULD BE REMUNERATED AT MARKET RATES.

- CENTRAL BANK SHOULD BE ACTING ONLY AS LENDER OF LAST RESORT AND SHOULD CHARGE MARKET-BASED INTEREST RATES.

- GOZ SHOULD BE MOVING TO REPLACE ADMINISTRATIVE CREDIT CEILINGS WITH INDIRECT CONTROLS ON CREDIT THAT ARE AUTOMATICALLY LINKED TO MOBILIZATION OF RESOURCES BY BANKING SYSTEM.

RELEASE OF SUBSEQUENT TRANCHES TIED TO SPECIFIC DEGREE OF PROGRESS EXPECTED IN ABOVE-NOTED AREAS. COVENANT CRITERIA REVISED TO POSSIBLY INCLUDE NOT ONLY PROGRESS IN THOSE BANKING SECTOR REFORMS NOTED ABOVE, BUT ALSO PROGRESS IN FOLLOWING AREAS:

- DEGREE TO WHICH COMMERCIAL BANKS ARE FINANCING A WIDER RANGE OF ENTERPRISES THAN BEFORE THE PSSP PROGRAM

- GOZ HAS IMPLEMENTED A POLICY OF FULL COST FUEL PRICING/RECOVERY

- GOZ IS MAINTAINING A LIBERAL POLICY CONCERNING FOREIGN TRADE IN COMMODITIES AND TARIFF-RATE REFORM

- GOZ IS MAINTAINING LIBERALIZED PRICING POLICIES AND HAS AGREED NOT TO INTRODUCE ADMINISTRATIVE CONTROLS ON PRICES OF PRIVATELY-PRODUCED GOODS AND SERVICES.

PROGRESS AGAINST THESE TARGETS WILL BE CRITICAL IN RELEASE OF FUNDS BUT FULL ATTAINMENT MAY BE BEYOND PURVIEW OF THIS PROGRAM.

OUTCOME OF ECPR ALSO DETERMINED THAT PROGRAM RATIONALE AND DESCRIPTION MUST REFLECT CLEARER LINKAGE AND MORE FOCUSED IMPACT OF PROGRAM ON INTENDED BENEFICIARY

GROUP. PAAD RATIONALE SECTION AUGMENTED TO DEMONSTRATE REQUESTED LINKAGES AND IMPACT. PRESENTATION SHOWED IMPACT ON MSES THEMSELVES AS WELL AS THAT ON CONSUMERS, MSE EMPLOYEES, SUBCONTRACTORS, EFFECT ON MARKETING AND DISTRIBUTION CHAIN AND LINKS TO AGRICULTURE AND RURAL AREAS.



C. ISSUE NO. 3: DEMONSTRATED COMMITMENT BY GOZ.

(1) NATURE OF ISSUE: GIVEN IMPORTANCE OF IMF/WORLD BANK AGREEMENTS TO SUCCESSFUL IMPLEMENTATION OF PROGRAM AND POSSIBILITY THAT AN AGREEMENT MAY NOT BE SIGNED THIS YEAR, THE QUESTION AROSE AS TO WHETHER THE PROJECT SHOULD BE AUTHORIZED. MISSION REPRESENTATIVES REQUESTED PROJECT APPROVAL AND AUTHORIZATION SO THAT THE MISSION COULD MAINTAIN BARGAINING LEVERAGE SHOULD THE NEGOTIATING CLIMATE IMPROVE AS EXPECTED.

(2) RESOLUTION OF ISSUE: SUBSTANTIVE AGREEMENT MUST BE REACHED ON CERTAIN KEY ISSUES BEFORE MISSION CAN GO AHEAD WITH PROGRAM.

THE PAAD AND PROJECT AUTHORIZATION WERE MODIFIED TO INCLUDE THE FOLLOWING THREE KEY PRIOR ACTIONS THAT MUST OCCUR PRIOR TO SIGNATURE OF THE PROGRAM AND PROJECT

AGREEMENTS:

- REDUCTION IN GAP BETWEEN OFFICIAL AND PARALLEL EXCHANGE RATES

- REDUCTION IN GAP BETWEEN INFLATION AND BANK OF ZAIRE'S INTEREST RATES ON ADVANCES TO COMMERCIAL BANKS

- EVIDENCE OF REVISION TO GOZ'S TAX COLLECTION PROCEDURES INCLUDING CUSTOM TAXES, TAX ADMINISTRATION AND AN INCREASE IN FUEL TAX.

3. DEADLINE. AUGUST 1 HAS BEEN SET AS DEADLINE DATE FOR FY 88 OBLIGATION OF THIS PROGRAM.

4. STATUS OF AUTHORIZATION: PAAD WITH REQUIRED CHANGES FINALIZED AND CURRENTLY IN CLEARANCE PROCESS. CN HAS GONE FORWARD TO HILL FOR REVIEW. WHITEHEAD
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ANNEX 10

STATUTORY CHECKLIST

PRIVATE SECTOR SUPPORT PROGRAM

PROJECT CHECKLIST

A GENERAL CRITERIA FOR PROJECT

1. FY 1989 Appropriations Act Sec. 523; FAA Sec. 634A. If money is sought to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified? **YES**

2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance? **YES**

3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance? **N/A**

4. FAA Sec. 611(b); FY 1989 Appropriations Act Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.) **N/A**

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively? **N/A**

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

NO

7. FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

PROGRAM WILL SUPPORT PRIVATE SECTOR DEVELOPMENT AND WILL IMPROVE CAPACITY UTILIZATION OF ZAIRIAN MANUFACTORING INDUSTRIES.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

PROGRAM WILL ENCOURAGE U.S. EXPORTS OF RAW MATERIALS, SPARE PARTS AND CAPITAL EQUIPMENT.

9. FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

THE GOZ WILL CONTRIBUTE $15 MILLION GOZ - OWNED COUNTERPART FUNDS FOR LOCAL COSTS OF THE PROGRAM.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

NO

11. FY 1989 Appropriations Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

N/A

12. FY 1989 Appropriations Act Sec. 549 Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel? — NO

13. FAA Sec. 119(g)(4)-(6) & (10). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas? — NO

14. FAA Sec. 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? — N/A

15. FY 1989 Appropriations Act. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from — N/A

sources other than the United States Government?

16. FY 1989 Appropriations Act Sec. 538. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? N/A

17. FY 1989 Appropriations Act Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained? N/A

18. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision). YES

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FY 1989 Appropriations Act Sec. 548 (as interpreted by conference report for original enactment). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct N/A competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

b. FAA Secs. 102(b), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

THE PROGRAM WILL ASSIST IN FINANCIAL SECTOR DEVELOPMENT AND REFORM AND WILL THUS SUPPORT THE SELF-HELP EFFORTS OF ZAIRE.

c. FAA Secs. 103, 103A, 104, 105, 106, 120-21; FY 1989 Appropriations Act (Development Fund for Africa). Does the project fit the criteria for the source of funds (functional account) being used?

YES (DFA)

d. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving,

N/A

labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

e. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

YES

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

YES

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country, utilizes the country's intellectual resources to encourage institutional development, and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

THE PROGRAM WILL WORK THROUGH EXISTING COMMERCIAL BANKING AND PRIVATE SECTOR INSTITUTIONS.

h. FY 1989 Appropriations Act Sec. 536. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

NO

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

NO

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| Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? | NO |
| i. FY 1989 Appropriations Act. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization? | NO |
| If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services? | N/A |
| j. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? | YES |
| k. FY 1989 Appropriations Act. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)? | AID DIRECT CONTRACTS UNDER THE PROGRAM WILL BE COMPETED UNDER FULL AND OPEN COMPETITION AND GRAY AMENDMENT ELIGIBLE ORGANIZATIONS WILL BE ENCOURAGED TO APPLY. |

1. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to

N/A

identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k)/utilize the resources and abilities of all relevant U.S. government agencies?

m. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b)/take full account of the environmental impacts of the proposed activities on biological diversity? — N/A

n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas? — NO

o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; — NO

(c) the colonization of forest lands; or (d) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

p. FY 1989 Appropriations Act. If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in accordance with the policies contained in section 102 of the FAA; (c) being provided, when conistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy

YES

reforms, the need to protect vulnerable groups; (e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the renewable natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

q. FY 1989 Appropriations Act Sec. 515. If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified? N/A

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. PROCUREMENT

1. FAA Sec. 602(a). Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? YES

2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him? YES

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? N/A

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) YES

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.) NO

6. FAA Sec. 603. Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and NO

tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?

7. FAA Sec. 621(a). If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? YES

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? YES

9. FY 1989 Appropriations Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? YES

10. FY 1989 Appropriations Act Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)? YES

B. CONSTRUCTION

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? N/A

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? N/A

3. FAA Sec. 620(k). If for construction of

productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP), or does assistance have the express approval of Congress? N/A

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter? N/A

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? N/A

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? YES

4. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f); FY 1989 Appropriations Act Secs. 525, 536. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; or (4) to lobby for abortion? YES

b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? YES

c. FAA Sec. 620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? YES

d. FAA Sec. 660. To provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? YES

e. FAA Sec. 662. For CIA activities? YES

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? YES

g. FY 1989 Appropriations Act Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? YES

h. FY 1989 Appropriations Act Sec. 505. To pay U.N. assessments, arrearages or dues? YES

i. FY 1989 Appropriations Act Sec. 506. To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? YES

j. FY 1989 Appropriations Act Sec. 510. To finance the export of nuclear equipment, fuel, or technology? YES

k. FY 1989 Appropriations Act Sec. 511. For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? YES

4. FY 1989 Appropriations Act Sec. 516; State Authorization Sec. 109. To be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress? YES

5. FY 1989 Appropriations Act Sec. 584. Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate? YES

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1989 Appropriations Act Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project. A CONGRESSIONAL NOTIFICATION WILL BE SUBMITTED BEFORE PROJECT AUTHORIZATION.

BEST AVAILABLE DOCUMENT

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

N/A

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

NO

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices, (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

PROGRAM WILL SUPPORT PRIVATE SECTOR DEVELOPMENT AND WILL IMPROVE CAPACITY UTILIZATION OF ZAIRIAN MANUFACTURING INDUSTRIES.

5. FAA Sec. 601(b). Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

PROGRAM WILL ENCOURAGE U.S. EXPORTS.

6. FAA Secs. 612(b), 636(h); FY 1989 Appropriations Act Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

N/A

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

NO

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? YES

9. FAA Sec. 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds? N/A

10. FY 1989 Appropriations Act. Will assistance be designed so that the percentage of women participants will be demonstrably increased? YES

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA? N/A

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities? N/A

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? N/A

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? N/A

e. FY 1989 Appropriations Act. If assistance is in the form of a cash transfer. (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currences that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. governnent as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available)? (c) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

N/A

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's

PROGRAM WILL ASSIST IN FINANCIAL SECTOR DEVELOPMENT AND REFORM AND WILL THUS SUPPORT SELF-HELP EFFORTS OF ZAIRE.

status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

PROGRAM IS FUNDED FROM DEVELOPMENT FUND FOR AFRICA ACCOUNT.

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs, and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under Sec. 104(b) or health under Sec.

104(c); if so, extent to which activity emphasizes low cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outrearch.

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

(4) [106] for energy, private voluntary organizations, and selected development problems; if so, extent activity is:

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

c. FY 1989 Appropriations Act. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the

YES

United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U. S. Government?

| | |
|---|---|
| d. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? | N/A |
| e. FAA Sec. 281(b). Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government. | PROGRAM WILL WORK THROUGH EXISTING COMMERCIAL BANKING AND PRIVATE SECTOR ISTITUTIONS. |
| f. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth? | YES |

ANNEX 11

GOVERNMENT OF ZAIRE (GOZ) REQUEST FOR ASSISTANCE

- PRIVATE SECTOR SUPPORT PROGRAM -

REPUBLIQUE DU ZAIRE
*Mouvement Populaire de la Révolution*

**DEPARTEMENT DU PLAN**

*LE COMMISSAIRE D'ETAT*

Kinshasa, le 26 MAI 1988

N° 220 /DP/BCE/KK/DSP/nln/88.-

TRANSMIS copie pour information aux :

- Citoyen Membre du Comité Central du M.P.R. et Premier Commissaaire d'Etat
- Citoyen Membre du Comité Central et Vice-Premier Commissaire d'Etat Chargé des questions économiques, financières et monétaires

(TOUS) à KINSHASA/GOMBE.-

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OBJET : Projet d'Appui au Secteur Privé.

A Monsieur le Directeur
de l'USAID
à KINSHASA/GOMBE.-

Monsieur le Directeur,

Me référant à l'entretien que nous avons eu relatif au sujet repris en marge, j'ai l'honneur de solliciter, au nom du Conseil Exécutif, une assistance financière sous forme de subvention, afin de nous permettre de financer, à travers le système bancaire, la relance des activités du secteur privé.

En effet, étant donné la conjoncture difficile que traverse notre pays en ce moment, les entreprises zaïroises tournent, d'une façon globale, nettement en dessous de leur capacité optimale par insuffisance de devises et de financement bancaire.
L'assistance que nous sollicitons nous permettrait donc de renflouer les ressources du système bancaire en vue, d'une part, de financer les importations de matières premières, de pièces de rechange et de biens d'équipement du secteur privé et, d'autre part, de nous aider dans des réformes du secteur financier envisagées dans le cadre du Programme d'Ajustement Structurel.
J'en profite pour vous indiquer que ces réformes préconisées visent à renforcer la stabilité du système bancaire et à inciter les banques à accroître leur capacité d'intermédiation en faveur du secteur privé.

Tout en vous remerciant à l'avance de l'appui que vous voudrez bien apporter à notre requête, je vous prie d'agréer, Monsieur le Directeur, l'assurance de ma haute considération.-

=. KASEREKA KASAI.-



4155, Rue des Coteaux — B.P. 9378 Kinshasa I — Tél 31332 - 31346 - 32843 — Télex 21.195

ANNEX 12

<u>ENVIRONMENTAL CATEGORICAL EXCLUSION</u>

- PRIVATE SECTOR SUPPORT PROGRAM -

# CATEGORICAL EXCLUSION

Project Country: Zaire

Project Title: Private Sector Support Project (660-0120

Funding: FY(s) 1988-90 US$ 40,000,000

CE Prepared by: G. William Anderson, PDO, USAID/Zaire

Environmental Action Recommended:

Positive Determination ________
Negative Determination ________
Categorical Exclusion X
Deferral ________

Summary of Findings:

This project is categorically excludable pursuant to the provisions of 22 CFR 216.2(c)(i) and (ix) because the project will support only (1) technical assistance, which will not involve construction or other activities affecting the environment, and (2) a Commodity Import Program, for which A.I.D., prior to approval does not have knowledge of the specific commodities to be financed, and will not have knowledge, at the time the assistance is authorized, nor control during implementation, of the commodities or their use in the host country.

Clearance:

Mission Director: Dennis M. Chandler Date: 08 JAN. 1988

Concurrence:

Bureau Environmental Officer: APPROVED: J J Gault (F.B. Boyd)

DISAPPROVED: ________

DATE: 2/1/88

Clearance:

GC/Africa: DWLuten Date: 2/1/88

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