

PDBBM 418

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET		1. TRANSACTION CODE <input checked="" type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete	Amendment Number _____	DOCUMENT CODE 3
2. COUNTRY/ENTITY ZAIRE		3. PROJECT NUMBER <input type="text" value="660-0120"/>		
4. BUREAU/OFFICE AFR		5. PROJECT TITLE (maximum 40 characters) <input type="text" value="PRIVATE SECTOR SUPPORT PROJECT"/>		
6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY <input type="text" value="09"/> <input type="text" value="30"/> <input type="text" value="93"/>		7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4) A. Initial FY <input type="text" value="88"/> B. Quarter <input type="text" value="4"/> C. Final FY <input type="text" value="90"/>		

8. COSTS (\$000 OR EQUIVALENT \$1 =)						
A. FUNDING SOURCE	FIRST FY			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	8395		8395	40,000		40,000
(Grant)	(8395)	()	(8395)	(40,000)	()	()
(Loan)	()	()	()	()	()	()
Other U.S.						
1.						
2.						
Host Country		1800			15,000	15,000
Other Donor(s)						
TOTALS	8395	1800	8395	40,000	15,000	55,000

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) DFA	700	840				8395		40,000	
(2)									
(3)									
(4)									
TOTALS						8395		40,000	

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 support the GOZ's Structural Adjustment Program by providing balance of payments support to the private sector while assisting implementation of policy changes that will enable Zairian commercial banks to expand financial services necessary for growth of the private sector, including medium and smaller-scale enterprises.

14. SCHEDULED EVALUATIONS	15. SOURCE/ORIGIN OF GOODS AND SERVICES
Interim MM YY MM YY Final MM YY <input type="text" value="06"/> <input type="text" value="90"/> <input type="text" value="09"/> <input type="text" value="91"/> <input type="text" value="07"/> <input type="text" value="93"/>	<input type="checkbox"/> 000 <input type="checkbox"/> 941 <input type="checkbox"/> Local <input checked="" type="checkbox"/> Other (Specify) <input type="text" value="935"/>

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

17. APPROVED BY	Signature Dennis M. Chandler	18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION MM DD YY
	Title Director, USAID/Zaire	

PRIVATE ENTERPRISE SUPPORT PROJECT

TABLE OF CONTENTS

PROJECT DATA SHEET	i
TABLE OF CONTENTS	ii
ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA	iv
PROJECT AUTHORIZATION	x
LIST OF ACRONYMS	xiv
MAP OF ZAIRE	xv
EXECUTIVE SUMMARY	xvi
1. <u>PROJECT RATIONALE AND DESCRIPTION</u>	1
1.1 The Problem	
1.2 The Private Sector Support Project (PSSP)	
1.3 PSSP Relationships with National Development Objectives and Strategies	
1.4 Relationship of PSSP to Development Fund For Africa (DFA) Regulation	
1.5 Beneficiary and Participant Involvement in PSSP Design	
2. <u>DISBURSEMENT SCHEDULE AND FINANCIAL FLOW ESTIMATES</u>	16
2.1 Methods of Financing	
2.2 Financial Accounting Mechanisms	
3. <u>IMPLEMENTATION PLAN</u>	21
3.1 Project Participants Responsibilities and Relationships	
3.2 Pre-Implementation Planning	
3.3 Project Monitoring and Evaluation Planning	
3.4 Implementation of Research, Impact Studies and Human Resources Development	
3.5 Operational Post-Project Agreement Implementation Plan	
3.6 Implementation Actions of A Continuing Nature	
4. <u>MONITORING PLAN</u>	30

TABLE OF CONTENTS (CONTINUED)

5.	<u>SUMMARIES OF PROJECT ANALYSES</u>	36
5.1	Technical Analysis	
5.2	Economic and Financial Analysis	
5.3	Social Soundness Analysis	
5.4	Administrative Analysis	
6.	<u>CONDITIONS AND COVENANTS</u>	57
7.	<u>EVALUATION</u>	66

ANNEXES

1	LOGFRAME Matrix	
2	Technical Analysis	
3	Economic Analysis	
4	Social Soundness Analysis	
5	Administrative Analysis	
6	Proposed Research, Evaluations and Impact Studies and Human Resources Development	
7	Implementation Procedures for Private Sector Financing	
3	Detailed Budget and Cost Estimates	
9	PID Approval Message	
10	Statutory Checklist	
11	Government of Zaire (GOZ) Request for Assistance	
12	Environmental Categorical Exclusion	

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Carol Peasley

Subject: Zaire: Private Sector Support Project (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 Project.
- II. Discussion: In conjunction with the overall economic stabilization and structural adjustment program in Zaire, this grant of \$40.0 million will (1) provide balance of payments support to the private sector and (2) assist financial sector reform and development to enable commercial banks to more efficiently mobilize and allocate financial resources to private enterprises. Project development has occurred in coordination with World Bank efforts in financial sector reform in Zaire.

The project has two main components. First, the project will provide both foreign exchange and local currency for short- and medium-term lending by commercial banks to medium- and small-scale Zairian private enterprises (MSEs). Second, the project will include policy reform objectives, policy analysis, and technical assistance to assist the Government of Zaire's (GOZ) financial sector reform effort.

As confirmed by analytical studies on the constraints and capabilities of Zaire's private sector, the project's commercial bank financing of medium- and small-scale Zairian private enterprises will enable MSEs to utilize idle capacity and increase their production and profitability. Foreign exchange will be disbursed through the normal bank letter of commitment and letter of credit mechanisms applicable to commodity import programs. Local currency lending under host-country owned local currency funds contributed by the GOZ will permit the purchase of locally available raw materials and goods, including agricultural products. Commercial bank financing of MSEs will occur at market rates of interest. Repayments of principal and interest will be deposited in a special account as required 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 project will assume the foreign exchange risk, while participating banks will assume the commercial risk and will be debited for repayments and interest regardless of whether their borrowers repay.

The project's financial sector reform component will assist in removing the regulatory and policy constraints that prevent the commercial banking sector from mobilizing and allocating efficiently domestic financial resources. Policy dialogue, studies, technical assistance and training will be combined to assist the GOZ in implementing effectively the financial sector reform program which it has developed.

Financial Plan: The Mission plans to obligate \$8,395,000 in the fourth quarter of FY 1988, \$16,000,000 in FY 1989, and \$15,605,000 in FY 1990.

AID and GOZ contributions by major category are as follows:

	<u>AID</u> \$000's	<u>GOZ</u> \$000's*	<u>TOTAL</u>
Private Sector Financing	\$35,000	\$13,500	\$48,500
Project Management	3,400	500	3,900
Studies and Short-Term Technical Assistance	950	500	1,450
Fiduciary Bank, Audits and Evaluation	650	500	1,150
TOTAL	<u>\$40,000</u>	<u>\$15,000</u>	<u>\$55,000</u>

III. Conditionality

Covenants. Given the importance of economic stabilization to the success of the project, the GOZ will agree to the following covenants:

- (1) Policy Dialogue. To meet and consult with AID at not less than six-month intervals, beginning no later than six months after the signing of the Project Agreement, in order 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 disbursements under the project. As soon as possible but not later than six months after the signing of the Project Agreement, the Cooperating Country shall agree with AID 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 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.
- 2) The GOZ will progressively reduce government budget deficits and take other steps to reduce the rate of inflation.
 - 3) The GOZ will continue its policy of liberalized interest rates.
 - 4) The GOZ will maintain a policy of floating exchange rates.
 - 5) The GOZ will practice a policy of full-cost fuel pricing.
 - 6) The GOZ will continue its program of tariff-rate reform.
 - 7) The GOZ will continue its liberalized pricing policy for agricultural and industrial products and will impose neither new ex ante nor ex post price controls.
 - 8) The GOZ will not allow the importation of pesticides under the project.

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 project management.

1) First Tranche

Prior to the first tranche of funds for commercial bank financing of eligible medium and small-scale private enterprises, the GOZ will:

- a) Issue a Financial Sector Development Policy Statement, embodying a liberal, private sector-oriented approach to financial sector reform and development. The reform program shall include measures to (1) promote commercial bank mobilization of domestic financial resources and savings; (2) foster a more active money market and interest rates representative of the real cost of funds; (3) increase the amount of credit available to private enterprises.

6

- (b) Provide a list of persons and agencies designated to participate in bi-annual consultations with AID to (1) monitor compliance with the reform measures agreed on and progress in the financial sector, (2) review the recommendations of studies carried out under the project and decide on appropriate action, and (3) review the results of project activities.

(2) Subsequent Tranches

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 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:
 - (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 project consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the project.

IV. 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 project meets specific objectives of the Development Fund for Africa (DFA) legislation contained in the FY 1988 Continuing Appropriations Resolution:

- o to help overcome shorter-term constraints to long-term development;
- o to bring about appropriate sectoral restructuring of the sub-Saharan economies; and
- o 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 assists in economic stabilization. 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.

Third, the PSSP fashions a critical link in USAID/Zaire's development strategy between structural reform and more targeted efforts in agriculture, rural transport, and health. General economic recovery and an effective commercial banking sector are prerequisites for a dynamic private sector. A growing private sector generates demand for local products as well as for better transport services. Dynamic enterprises also create resources and revenues that can help pay for the continuation of targeted development activities in agriculture, rural transport, and health.

B. 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.

C. Implementation Agencies:

The Project 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.

D. Responsible Officers:

G. William Anderson, Chief, USAID/PDO in Zaire, is the officer responsible for the project in the field. Jim Hradsky, Chief AFR/PD/CCWAP, is the officer responsible for the project in AID/W.

E. Statutory Checklists:

Are attached to the PP.

F. 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."

G. Source/Origin and Nationality:

As a DFA-funded project, the PSSP will have a Code 935 source/origin authorization. USAID/Zaire will treat the commodity import component as a 941 activity and expects that nearly all the foreign exchange will be used to finance Code 941 commodities. Local companies will be encouraged to look first to the U.S., then to developing countries for their imports. For goods to be purchased from Code 935 countries, USAID will require proof of market surveys demonstrating that the items are not available in 941 countries at a comparable price. Authorization of services procurement from other than Code 000 is not expected.

H. Local Cost Financing:

Dollar disbursements for local costs is not expected and will not be made unless programming determinations required by Handbook 18, Chapter 18 have been executed. Local currency financing, if any, only applies to the project management, technical assistance, and studies portion of the project.

I. Notification to Congress:

The Congressional Notification for this project was forwarded on _____, 1988. The fifteen day waiting period expired _____, 1988 without objection.

V. Recommendation: The Africa Bureau ECPR reviewed and approved the PSSP on _____, 1988 and found the project to be technically, economically, financially, socially, and administratively sound. It is recommended that you sign the attached authorization and thereby approve life of project funding of the PSSP of \$40 million.

Attachment: Project Paper
Clearances:

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 Foreign Operations, Export Financing, and Related Programs Appropriations Act of 1988, I hereby authorize the Private Sector Support Project for the Republic of Zaire, involving planned obligations of not to exceed \$40,000,000 in grant funds, over a three-year period from 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. The planned life of the project is five years from the date of initial obligation.

2. The project will (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. It is expected that, except as A.I.D. may otherwise agree in writing,

(1) Commodities financed by A.I.D. under the project shall have their source and origin in countries included in A.I.D. Geographic Code 935.

(2) The suppliers of commodities financed by A.I.D. under the project shall have countries included in A.I.D. Geographic Code 935 as their place of nationality.

(3) The suppliers of services financed by A.I.D. under the project shall have the United States as their place of nationality.

(4) Ocean shipping financed by A.I.D. under the project, shall be financed only on flag vessels of the United States, if available as determined by SER/OP/TRANS.

In practice, the implementation of these source, origin and nationality requirements will be in accordance with procedures described in the project paper and in accordance with Agency guidance, as may be issued from time to time.

b. Condition Precedent to First Disbursement. Prior to any disbursement, or the issuance of any commitment documents under the Project 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.

c. Condition Precedent to First Disbursement for Commercial Bank Financing of Private Enterprises. Prior to any disbursement under the Project Agreement, or the issuance of any commitment documents under 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.

(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 Project Agreement, in order 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, and review the results of project activities.

d. Condition Precedent to Subsequent Disbursements for Commercial Bank Financing of Imports by Private Enterprises. Prior to each subsequent disbursement, or the issuance of any commitment documents under the Project Agreement, to provide funding for commercial bank financing of private enterprises, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing,

(1) Take those measures agreed upon with A.I.D. during the regular Cooperating Country/A.I.D. 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) Demonstrate during the regular Cooperating Country/A.I.D. project consultations that the agreed-upon monitoring criteria have been met with respect to progress on the financial reforms envisaged under the project.

e. Covenants

The Cooperating Country shall covenant:

(1) To 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 Project Agreement, in order 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 disbursements under the project. As soon as possible but not later than six months after the signing of the Project 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.

(2) To 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) To continue a policy of liberalized interest rates.

(4) To 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) To practice a policy of full-cost fuel pricing.

(6) To 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) To maintain liberalized pricing policies and not to introduce administrative controls, ex ante or ex post, on prices of private goods and services.

(8) Not to allow the importation of pesticides under the project.

Date: _____

Signature: _____

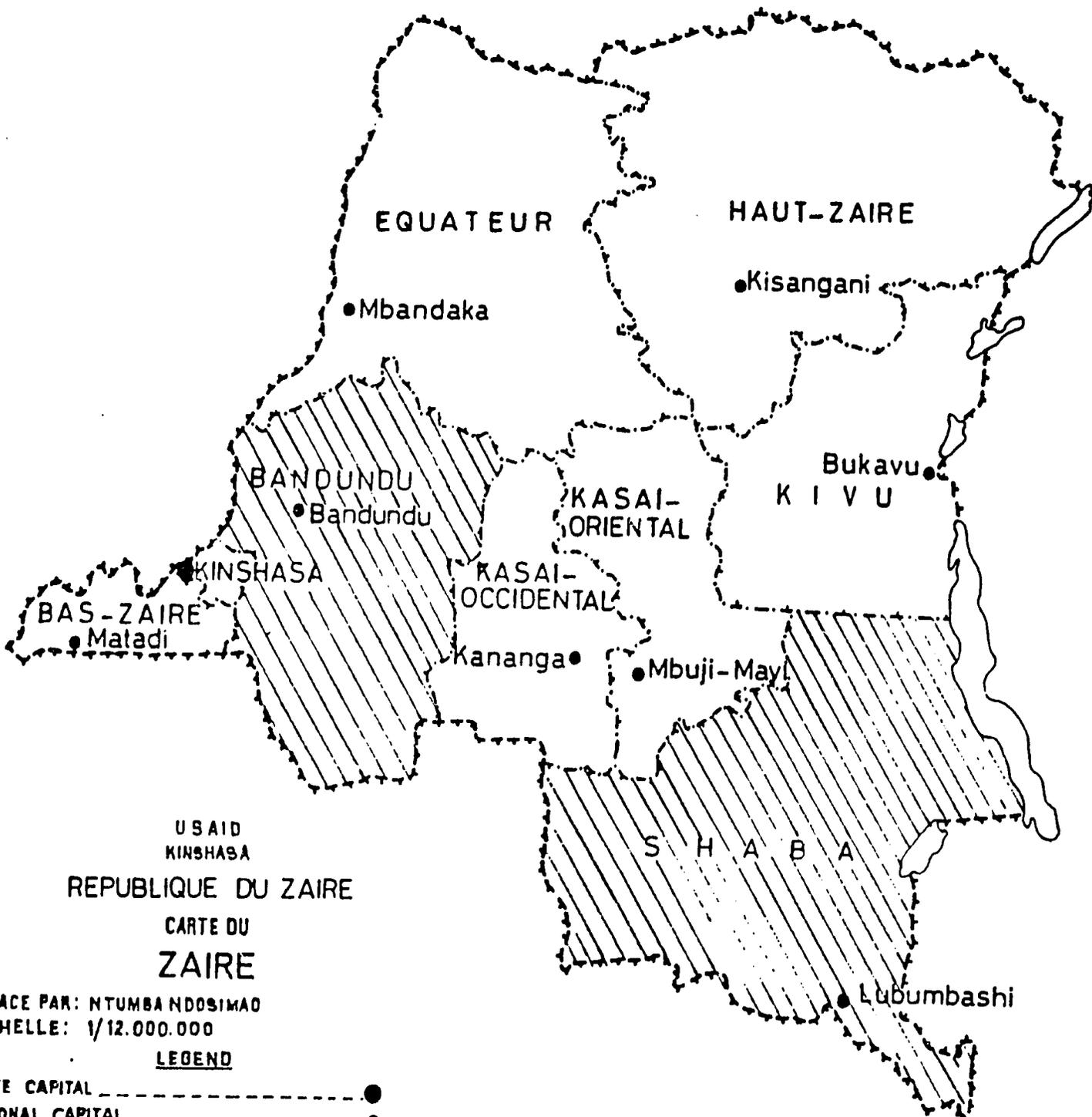
Charles Gladson
Assistant Administrator
Bureau for Africa

Clearances: As shown on the action memorandum

PRIVATE SECTOR SUPPORT PROJECT (660-0120)

List of Acronyms

AEPRP	African Economic Policy Reform Program
AFECOZA	Association des Femmes Commerçantes 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 Zaïre (Central Bank)
BEDEPE	Bureau d'Encouragement au Développement des Petites Entreprises
BIAZ	Banque Internationale de l'Afrique au Zaïre
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 Developpement (development bank)
SONAS	Societe Nationale d'Assurances (National Insurance Company)
USAID	United States Agency for International Development
UNDP	United Nations Development Program



USAID
KINSHASA
REPUBLIQUE DU ZAIRE
CARTE DU
ZAIRE

TRACE PAR: NTUMBA NDO SIMAO
ECHELLE: 1/12.000.000

LEGEND

- STATE CAPITAL ———●
- REGIONAL CAPITAL ———●
- STATE LIMIT ———▲▲▲
- REGION LIMIT ———▲▲▲
- LAKE ———
- REGIONS OF CONCENTRATION FOR AID PROGRAM ———

EXECUTIVE SUMMARY

Grant: \$40.0 million for disbursement over three years with \$8,395,000 to be obligated in FY 1988.

Grantee: Government of Zaire (GOZ)

Implementing Agency: Office of the Minister of Plan.

USAID/Zaire proposes to provide \$40 million in quick disbursing balance of payments support to be used for essential private sector imports while assisting implementation of policy changes in the financial sector. These policy changes will enable Zairian commercial banks to expand financial services necessary for growth of the private sector. The direct target group for private sector financing under the project consists of medium and smaller-scale enterprises (MSEs).

1. The Problem

In 1983, Zaire embarked upon a long term economic stabilization and liberalization program in an attempt to overcome a long and severe economic crisis. As part of this program, the GOZ has adopted many important and far-reaching policy reform measures. In spite of the fact that adoption of these measures has often been unpopular and difficult, the GOZ seems determined to continue and expand its reform program.

The GOZ has given the private sector a major role in leading the economy to recovery. The sector has responded, but it faces two major problems itself in fulfilling a key role in economic recovery: lack of sufficient foreign exchange to keep plants operating at normal capacity levels and the serious financial sector constraints that limit enterprises' ability to obtain the credit required to expand their operations.

Zaire, like most developing countries, depends upon a limited number of mineral and agricultural products for its foreign exchange earnings. While output has increased in response to reform measures, international price movements have negated much of the foreign exchange gains expected from increased export quantities. This factor, combined with continued heavy debt repayment levels, has resulted in a continuous serious foreign exchange shortage. It is estimated that at present there is a minimum structural shortage of roughly \$10 million per month for financing letters of credit, which banks would open for credit-qualified private sector importers of essential commodities 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. Partly, this is the result of continued high and fluctuating inflation, which increases the risks of credit and has driven most firms to self-financing 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, but since borrowers must bear foreign exchange risk such loans have proven to be extremely dangerous. Due to high inflation and thin credit markets, interest rates, although no longer under government control, are sticky and not responsive to supply and demand. Several financial institutions - particularly government controlled entities - need rehabilitation, although the core of the private commercial banking sector is sound. As a result of the conditions described above, however, Zairian private banks serve mainly as foreign-exchange dealers, concentrating primarily on very short-term trade financing, while limiting their lending mainly to short-term advances to preferred clients.

Long-term development of the private sector and of the Zairian economy as a whole depends on a viable, functioning financial sector. Efforts are underway to initiate financial sector reforms that will help the sector play a larger developmental role. This project is one of those efforts. The World Bank is proposing a Financial Sector Adjustment Credit (FSAC) for 1988, with the objective of providing - as in this USAID proposal - foreign exchange to the economy while promoting financial sector policy reform. The GOZ has requested USAID to coordinate with other donors in this area, and the Mission has been actively involved in discussions with the World Bank and the IMF to develop a mutually consistent effort. This document reflects these discussions.

2. The Private Sector Support Project (PSSP)

The Private Sector Support Project's purpose is to:

- o Provide quick disbursing dollar grant funds (\$35 million) which will support Zaire's balance of payments.
- o Obtain policy reforms in the financial and banking sector which will encourage commercial bank medium and long term lending to private sector MSEs.
- o Provide direct assistance to MSEs via commercial bank intermediation of private sector foreign exchange denominated imports and local currency lending supported by a local currency counterpart fund.

The project will achieve this purpose in two ways. First, the project will provide foreign exchange and local currency for short- 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 term 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.

Second, the project will facilitate development of the financial sector, which by the end of the project will be able to more efficiently mobilize and allocate financial resources to private enterprises. The project 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.

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

To help ameliorate foreign exchange shortages, 35 million dollars in project funds and 13.5 million dollars in local currency will be made available to finance eligible private sector Zairian businesses. 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.

Participating private enterprises drawing on the project'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 project 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.

2) Addressing Financial Sector Development Needs

While the above project component will help to address the immediate problem of foreign exchange and credit limitations for the private sector, there is a need to assist the GOZ to address the longer-term constraints that are preventing the financial sector from mobilizing the financial resources necessary for long-term growth of the private sector.

The second project 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 implement a 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.

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

- o Basic covenants concerning continuation of stabilization and liberalization measures will include provisions for control of the deficit and liberalization of prices, interest rates, and exchange rates.
- o Commitments by the GOZ to long-term 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 project 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 expand credit to private enterprise by mobilizing a larger share of national liquidity.

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.

3) Meeting Development Fund for Africa (DFA) Objectives

The PSSP is the central piece of USAID's private sector development strategy in Zaire. The project meets specific objectives of the Development Fund for Africa (DFA) legislation contained in the FY 1988 Continuing Appropriations Resolution:

- o to help overcome shorter-term constraints to long-term development;
- o to bring about appropriate sectoral restructuring of the sub-Saharan economies; and
- o 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 assists in economic stabilization. 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.

Third, the PSSP fashions a critical link in USAID/Zaire's development strategy between structural reform and more targeted efforts in agriculture, rural transport, and health. General economic recovery and an effective commercial banking sector are prerequisites for a dynamic private sector. A growing private sector generates demand for local products as well as for better transport services. Dynamic enterprises also create resources and revenues that can help pay for the continuation of targeted development activities in agriculture, rural transport, and health.

3. Project 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 tranching 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 project activities and conditionality, and (7) managing the performance of the principal contractors in meeting project objectives.

1. PROJECT RATIONALE AND DESCRIPTION

The per capita output of goods and services in Zaire appears to have fallen or stagnated virtually every year since 1974. This has occurred in spite of positive aggregate GNP growth achieved since 1983 in response to national stabilization policy measures. Rapid population growth and falling terms of trade have contributed to the decline in per capita output. Manufacturing's share of total output declined roughly from 10 percent to 5 percent, between the early 1970s and the 1980s. Financial constraints underlie much of this decline: lack of foreign exchange and local currency working capital needed to more fully utilize existing installed private sector production capacity. Substantial growth in output of existing under-utilized production facilities is possible, particularly those serving local markets, provided that more foreign exchange and local currency working capital can be made available.

USAID/Zaire proposes a \$40 million balance of payments support grant made in tranches over a three year period in direct support of GOZ's Structural Adjustment Program. The PSSP, which has a five-year life, has been designed to accomplish two other purposes:

- o To obtain policy changes which will improve the banking sector's ability to mobilize funds and increase lending to MSE's.
- o To provide direct assistance to private sector medium and smaller-scale enterprises MSEs requiring access to foreign exchange for essential imports of raw materials, supplies, spare parts and equipment, and to local currency credit for working capital and local purchases.

1.1 The Problem

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.

The GOZ has given the private sector an important role in leading the economy to recovery. The sector has responded, but

it faces serious problems itself in fulfilling this lead role. Two major problems hindering the sector are the lack of sufficient foreign exchange to keep plants operating at reasonable capacity levels and the serious financial sector constraints that limit the ability of private firms to access the credit required to expand their operations.

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.

Long-term development of the private sector depends on a viable, functioning financial sector. Efforts are underway to initiate financial sector reforms that will help the sector play a larger developmental role. This project is one of those efforts. In addition, the World Bank is proposing a Financial Sector Adjustment Credit (FSAC) for 1988. The overall objectives of the FSAC, in common with this USAID proposal, are to provide foreign exchange to the economy while promoting financial sector

policy reform. The GOZ has requested USAID to coordinate with other donors in this area, and the Mission has been actively involved in discussions with the World Bank and the IMF to develop a consistent effort.

1.2 The Private Sector Support Project (PSSP)

The Private Sector Support Project's purpose is:

- o To provide quick disbursing dollar grant funds (\$35 million) which will support GOZ balance of payments.
- o To obtain policy reforms in the finance and banking sector which will encourage commercial bank medium and long term lending to private sector MSEs.
- o To provide direct assistance to MSEs via commercial bank intermediation of private sector foreign exchange denominated imports and local currency lending supported by a local currency Counterpart Fund.

The project will achieve this purpose in two ways. First, the project will provide foreign exchange and local currency for short- 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 term lending (1) will help stabilize the market for foreign exchange and encourage further liberalization and (2) will boost private sector activity during the period when financial sector reform and development are occurring.

Second, the project will facilitate evolution of the financial sector, which by the end of the project will enable commercial banks to more efficiently mobilize and allocate financial resources to private enterprises. The process of financial sector reform will promote mutual consultation between the GOZ and USAID on the objectives and elements of the financial sector development program. Releases of funds for imports will occur in tranches in coordination with the elaboration and execution of this program.

The PSSP's larger 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.

(1) Addressing Foreign Exchange Shortages And Short-Term Credit Constraints

Thirty-five million dollars in project funds and \$13.5 million in local currency will be made available to finance eligible Zairian businesses. The foreign exchange will be used to import raw materials, spare parts, and equipment. Local currency from the GOZ contribution will be used for agricultural buying campaigns or to purchase similar materials available locally.

Participating commercial banks drawing on the project's foreign exchange or counterpart funds will incur a repayment obligation to the counterpart fund in local currency. The banks will also obligate short- and medium-term local currency loans to the enterprises. The banks' repayment obligations to the Counterpart Fund will be independent of the repayment of the enterprises' loans, so the banks will bear the commercial risk. The terms of repayments to the Counterpart Fund will, however, cover the funding needs of the banks. Private commercial banks in Zaire will open and confirm letters of credit for imports in a Commodity Import Program (CIP) process, and will collect repayments from importers on behalf of the Counterpart Fund.

The project also provides for monitoring commercial bank financing of private enterprises and identification of further obstacles to 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 as conditions precedent or as benchmarks for measuring performance against PSSP objectives.

(2) Addressing Financial Sector Development Needs

In addition to providing foreign exchange and local currency credit to the private sector, there is also a need to assist the GOZ to address the longer-term constraints that are preventing the financial sector from mobilizing the domestic financial resources necessary for long-term growth of the private sector.

This policy reform component will provide \$5 million in project funds and \$1.5 million in local currency to the GOZ to help implement a financial sector reform program that will provide the overall structure and incentives for the commercial banking system to mobilize domestic resources for on-lending to the private sector.

The GOZ, through its central bank, the Bank of Zaire, has agreed that USAID will participate in formulating and assisting the financial sector development program and regular GOZ/AID consultations will take place in coordination with World Bank efforts in the financial sector under the World Bank Financial Sector Adjustment Credit (FSAC). The policy reform program under the PSSP will consist of three parts.

First, there will be basic covenants to continue and expand stabilization and liberalization measures, including control of the deficit and liberalization of prices, interest rates, and exchange rates.

Second, commitments by the GOZ to long-term financial sector development and to USAID participation in designing and supporting this program will be conditions precedent to the initial release of funds for import financing.

Third, specific measures promoting bank mobilization and allocation of resources to the private sector will be reviewed prior to subsequent releases of project funding. Measures ready for implementation in 1988 will:

- o Promote a more active money market among banks and other financial institutions, so as to support the establishment of truly market-determined interest rates, and
- o Improve the incentive framework for banks to expand credit to private enterprise by mobilizing a larger share of national liquidity.

The GOZ and USAID will consider 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 tranches of funding under the PSSP. The policy reform program will be supported by technical assistance and training. Refer to Section 6, Conditions And Covenants for a more detailed discussion of the conditionality.

(3) Managing The Private Sector Support Project

Local commercial banks participating in the PSSP will offer foreign exchange facilities to eligible private sector importers using Commodity Import Program (CIP) mechanisms (see Annex 7, Implementation Procedures for Private Sector Financing

for details on these mechanisms). USAID's management and control systems for this type of operation already exist under current CIPs. A local bank will be contracted to act in a fiduciary relationship between USAID and the participating banks. While final approval of transactions under the PSSP will remain with USAID, the fiduciary bank will act as a repository for counterpart funds generated by the program and will provide collection, accounting and reporting services for local currency generations from both the foreign exchange CIP and the local currency lending programs. 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 tranches release of funds, (4) modifying reform targets and timetables to meet current conditions, (5) monitoring commodity transactions to ensure compliance with AID Regulation I and project objectives, (6) managing studies and analyses to determine the actual impacts and implications of project activities and conditionality, and (7) managing the performance of the principal contractors in meeting project objectives.

1.3 PSSP Relationships with National Development Objectives and Strategies

The Private Sector Support Project 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) Conformity Of PSSP With Zaire's Development Strategy And Programs

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, The Economic Analysis, 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.

- o 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.
- o The growth of private credit has also been controlled in the framework of the Stand-By Agreements.
- o 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.
- o 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 de-control 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 short-term objective of USAID's Private Sector Support Project will be to support continuation of the GOZ's overall economic program by supplying balance of payments support and term credit directly to the private sector. Given the present relatively difficult balance of payments situation and the historical record of the negative influence this can have on the GOZ's reform program, this short-term objective is critical. The GOZ and the World Bank have both urged the United States to concentrate more of its assistance on fast-disbursing aid to the private sector.

The Private Sector Support Project 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 in the Structural Adjustment Program, the joint World Bank/IMF Structural Adjustment Program for 1987 contained a financial sector element which initiated discussions in the area of credit policy. 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 Project 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 project 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 Project 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 condition-

ality, and the private sector. This is evident in the CDSS Update of 1985 with its emphasis on "stabilization support." This emphasis was strengthened in 1985 by including the Private Sector Support Project in the FY 1987 ABS and 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, an FY 1989 AEPRP-II dealing with Fuel and Transport sector reform and 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. Thus, while USAID continues major projects in health, population, rehabilitation of rural roads, and agricultural production, a shift in resource allocation is taking place favoring program and private sector assistance.

USAID expects to reflect this strategic program shift in a new CDSS to be completed early in 1989. The mission considers the Private Sector Support Project a central element in this strategy, which is expected to include a set of interventions directed toward promoting private enterprise. The present project 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 Project 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 Project continues USAID's strategy of using private commercial banks as implementing institutions in assisting the private sector. The PL 480 program and three CIPs (560-0100, 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 Project. The project will seek to stimulate a wider range of banking services such as term credit to a new clientele of MSEs.

The project's emphasis on stabilization support, the private sector, the financial sectors, 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

Development Fund for Africa (DFA) legislation contained in the FY 1988 Continuing Appropriations 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...".

In the May, 1985 Update of the Zaire CDSS, AID determined that macroeconomic instability and disequilibrium in the GOZ's budget were major obstacles to the implementation and effectiveness of USAID/Zaire's programs in all fields, including agriculture, health and population. It was therefore determined that USAID/Zaire's program should include a new component directly supporting macroeconomic stabilization, so that the overall AID portfolio in Zaire would make a balanced response to the major factors depressing the standard of living.

The PSSP is the first project funded from Development Assistance (now, Development Fund for Africa) monies whose purpose is to respond to the CDSS's determination of the need for a stabilization support element in USAID/Zaire's program. While

retaining this central purpose, the PSSP has been designed to target funds to the private sector rather than to the GOZ, and to medium-size rather than larger firms, so as to have more social impact while retaining the central project objective of quick disbursing stabilization support. The PSSP is also conditioned on the GOZ's implementation of financial sector reform. Consequently, the project's impact will go beyond short-term stabilization support to improve the medium-term economic environment for increased employment and income, improved supplies of consumption goods, and improved urban markets for agricultural products.

One aspect of the PSSP's conditionality requires the GOZ to 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 renaissance 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 project.

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. 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 is aimed at one of the keys to private sector recovery and accelerated development, the commercial banking sector, while supporting overall economic stabilization efforts.

The project 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.

1.5 Beneficiary And Participant Involvement In PSSP Design

The PSSP Project Paper 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 Project 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:

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

After project 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 that 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 led 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 Project 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.

2. DISBURSEMENT SCHEDULE AND FINANCIAL FLOW ESTIMATES

The PSSP finances a \$40 million grant from AID for quick disbursing balance of payment 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 \$8,395,000 in the fourth quarter of FY 1988, \$16,000,000 in FY 1989, and \$15,605,000 in FY 1990. 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 2.1, Summary Cost Estimate and Financial Plan, which follows this page for a summary of the source and application of funds.

EXHIBIT 2.1

SUMMARY COST ESTIMATE AND FINANCIAL PLAN

- PRIVATE SECTOR SUPPORT PROJECT -

(\$000)

SOURCE 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. 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

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 PROJECT -

TABLE I

EXPENDITURES	(\$000)					TOTAL
	YR 1	YR 2	YR 3	YR 4	YR 5	
<u>USAID</u>						
1. BOP/CIP	\$11,125	\$11,360	\$12,515	-	-	\$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	\$12,000	\$12,395	\$13,545	\$ 1,005	\$ 1,055	\$40,000
<u>GOZ*</u>						
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	\$13,800	\$15,695	\$17,345	\$ 5,305	\$ 2,855	\$55,000

*DOLLAR EQUIVALENT

3. IMPLEMENTATION

The implementation plan described below addresses the four key implementation elements: project management, program planning and scheduling, financial management, and project 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 Project 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.

o 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 project. 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.)

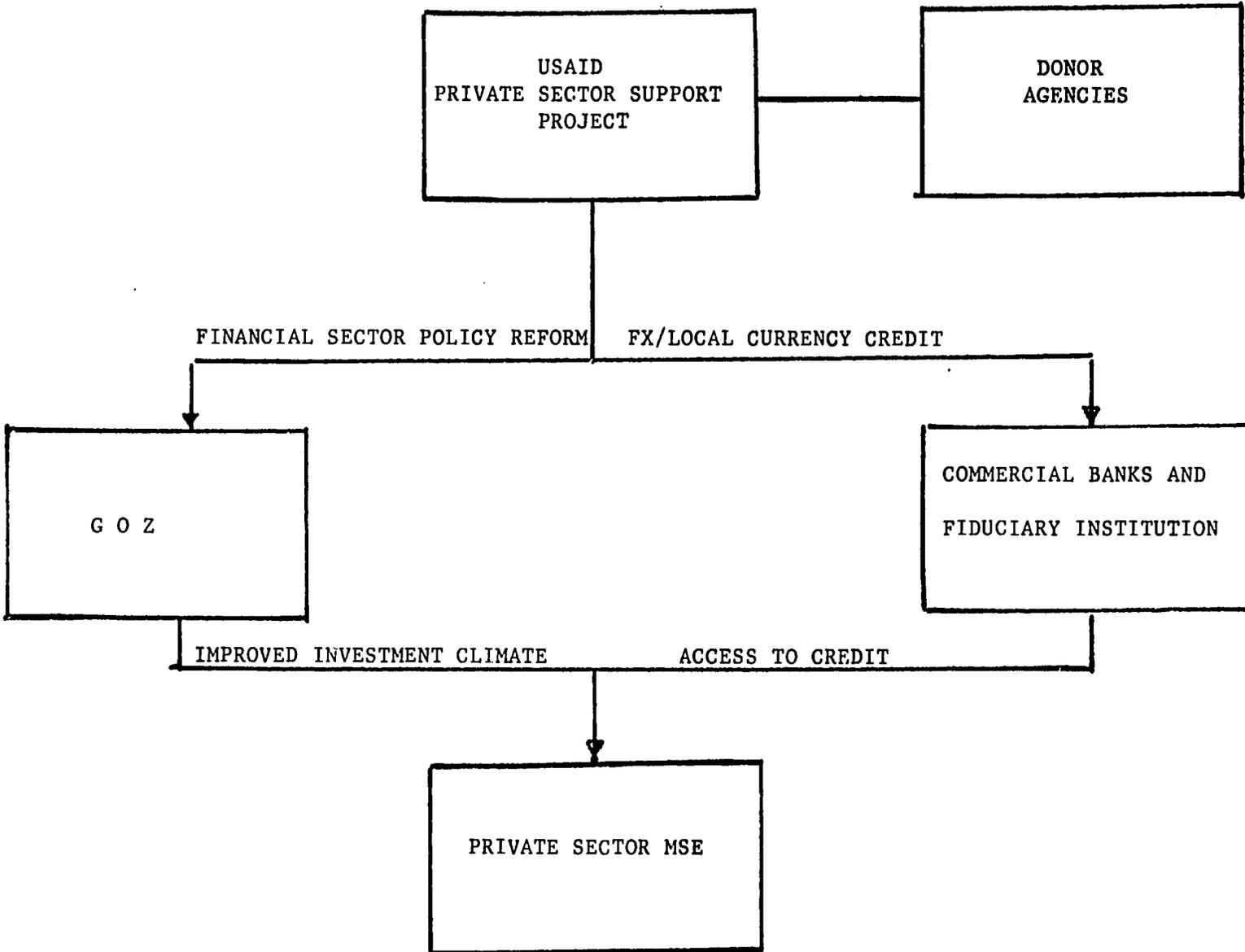
o Project Management And Related Advisory And Support Services

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.)

BASIC PROGRAM OBJECTIVES AND PARTICIPATING ORGANIZATIONS

- PRIVATE SECTOR SUPPORT PROJECT -



The PSSP Project 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.

o 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.

o Fiduciary Bank

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

o 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.

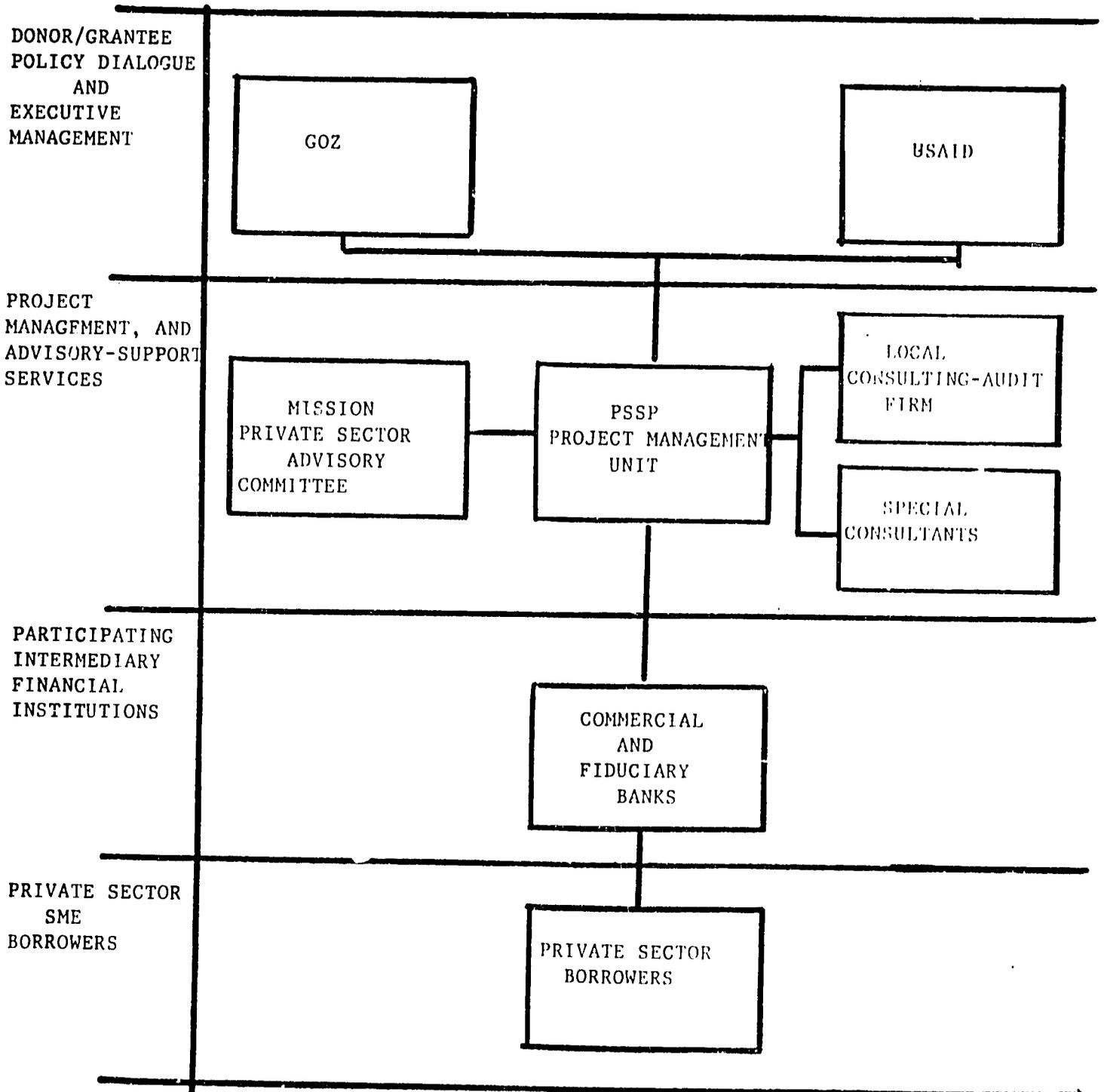
Exhibit 3.2, Project Structure, depicts the relationships and responsibilities described above.

3.2 Pre-Implementation Planning

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

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

PROJECT STRUCTURE
PRIVATE SECTOR SUPPORT PROJECT



- o Conduct of a social soundness analysis including women in development issues;
- 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 project start up.

- o Project Paper 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, Implementation Planning Actions, which follows this page, for a summary of these and other implementation start-up actions.

3.3 Project Monitoring And Evaluation Planning

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

DATE

1988 MAY JUN JUL AUG SEP OCT NOV DEC 1989 JAN FEB MAR APR MAY JUN JUL
0 1 2 3 4 5 6 7 8 9 10 11 12 13 14

- 1.00 PE AUTHORIZATION
- 1.10 PRONG signature
- 1.20 PIL 1
- 1.25 Program announcement
- 1.30 Planning
- 1.35 RPS 1st yr ops consult. studie.
- 1.40 complete HIA design
- 2.00 Project Management
- 2.10 specification of ITRP house fact.
- 2.20 specification/prepare 1 yr work.
- 2.25 develop/prepare ITRP plan & sche.
- 2.30 Contracting
- 3.00 PHU HRS
- 3.10 Interview Project Hrs candid.
- 3.15 select Project Hrs
- 3.18 security clearance Project Hrs.
- 3.19 Negotiation and contract Hrs
- 3.20 interview other PHU member
- 3.21 short list other position
- 3.22 Interview other position
- 3.23 select candidates other post
- 3.24 security checks on other
- 3.25 Negotiation with others
- 3.26 sign contracts with others
- 3.27 orientation of others
- 3.30 office equip
- 3.31 develop specs
- 3.32 RPO's for equip issued
- 3.33 P&S contract/work order signed.
- 3.34 procurement period
- 3.50 fiduciary Bank contracts
- 3.51 RARPCO approval fiduciary RFP.
- 3.52 sign fiduciary contract
- 3.53 contract consulting audit firm.
- 3.54 RARPCO approval audit contrac.
- 3.55 sign audit contract
- 3.56 bank circular prepared & issue.
- 3.57 specification/agree disburse proced.
- 3.58 open bank accounts
- 3.59 bank/prepare proceed/approv
- 3.59 condition disburse mechanism
- 3.59 condition L/C/MH mechanism
- 3.59 condition L/R mechanism
- 4.00 Financial Management
- 4.20 specify pro ITRP accounting syste.
- 4.21 develop acct system in place
- 4.30 prepare time-phased Fin plan
- 4.40 billio./release funds to con bank.
- 4.40S initiate con bank finan HSEs
- 4.41 and obligation/release
- 5.00 Project Execution
- 5.20 1st bi-annual review/consultat.

EXHIBIT 3.3

IMPLEMENTATION START-UP ACTIVITIES

- PRIVATE SECTOR SUPPORT PROJECT -

GANNT CHART REPORT - Current Date: 05-20-88

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-Project 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:

- o The CIP nature of the project places much of the responsibility for non-policy implementation actions outside formal GOZ channels and actions.
- o 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.
- o 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 project management tasks.
- o Mission workloads apart from the PSSP dictated maximum delegation of routine implementation tasks to a Project Management Unit able to operate on a semi-independent basis, while having access to consultants for special studies and project monitoring, impact and evaluation responsibilities.
- o 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.

EXHIBIT 3.4
MAJOR RECURRING IMPLEMENTATION ACTIONS FOLLOWING PROJECT START-UP PHASE

<u>TASK</u>	1989				1990				1991				1992				1993			
	<u>QUARTER</u>				<u>QUARTER</u>				<u>QUARTER</u>				<u>QUARTER</u>				<u>QUARTER</u>			
	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			
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	
Project 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 Project 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.

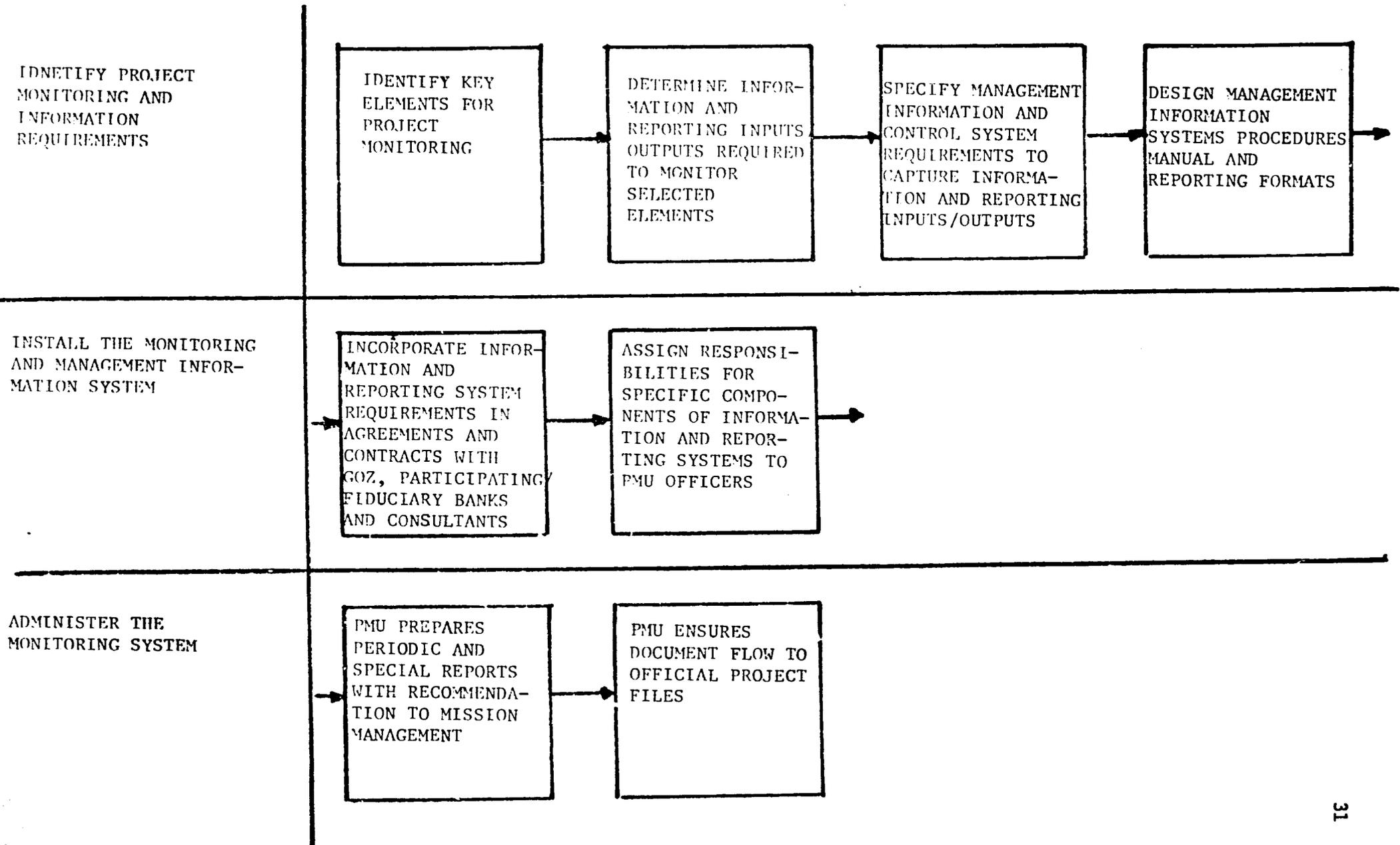
The design and installation of the PSSP Project monitoring system will be accomplished in three steps.

- 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

PROJECT MONITORING SYSTEM
PRIVATE SECTOR SUPPORT PROJECT



5/27 x

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

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

MONITORING ELEMENT	DATA REQUIRED FOR MONITORING	RESPONSIBILITY	PROJECT INFORMATION SYSTEM SOURCE
<p>1. <u>VERIFY GOZ COMPLIANCE WITH CONDITIONS PRECEDENT, CONDITIONALITIES AND COVENANTS</u></p> <p>(1) Obtain documentation and legal opinions. (2) Propose extensions and modifications. (3) Alert mission management to non-compliance and recommend action. (4) Confirm conditions precedent met and issue PIL. (5) Oversee compliance with covenants and conditionalities.</p>	<p><u>PROGRAM CONDITIONS PRECEDENT:</u></p> <ul style="list-style-type: none"> o Financial Development Policy Statement. o GOZ request to assist in policy implementation. o Formation of Advisory Consultative Group. <p><u>MACROECONOMIC COVENANTS AND CONDITIONS:</u></p> <ul style="list-style-type: none"> o Guarantees for maintenance of critical liberalization policies: budget deficit limitations, price liberalization, market determined interest exchange and fuel rates. <p><u>RELEASE OF SECOND TRANCHE:</u></p> <ul style="list-style-type: none"> o Measures taken re promoting money markets and market determined interest rates. o Incentives established for banks to extend credit to private sector via bank mobilization of larger share of national liquidity. <p><u>RELEASE OF SUBSEQUENT TRANCHES:</u></p> <ul style="list-style-type: none"> o Further measures aimed at promoting more active money market and improving bank incentives to mobilize domestic savings. 	<p>PDO Project Manager Economist (assisted by USAID Prog. Economist) Financial Sector Economist</p>	<p>Compliance monitoring accomplished by continuing policy dialogue and Consultative Group discussions.</p>
<p>2. <u>ENSURE CONTRACTS AND AGREEMENTS NEGOTIATED AND SIGNED</u></p>	<p><u>PERSONNEL:</u> PSC contracts signed on schedule. <u>OFFICE AND HOUSING FACILITIES:</u> Procurement and contracting completed on schedule. <u>PARTICIPATING ORGANIZATIONS:</u> Agreements and contracts with participating banks, fiduciaries and consultants signed on schedule.</p>	<p>PROJECT MANAGER</p>	<p>PMU will follow conformity with implementation schedule working closely with the mission's legal contracts and administrative units.</p>

5/4
x

Exhibit 4.2 Continued

MONITORING ELEMENT	DATA REQUIRED FOR MONITORING	RESPONSIBILITY	PROJECT INFORMATION SYSTEM SOURCE
3. <u>MONITOR COMPLIANCE WITH TERMS AND CONDITIONS FOR USE OF FOREIGN EXCHANGE</u>	<p><u>BORROWERS:</u> Specifications and restrictions honored by participating banks. Target groups being reached.</p> <p><u>IMPORTS:</u> Commodity restrictions observed.</p> <p><u>SOURCE:</u> Supplier source country restrictions observed.</p>	PROJECT MANAGER FN Commodity Staff	Project MIS system will be assisted by outside auditors who will provide control information. See Annex 5, <u>Administrative Analysis</u> .
4. <u>MONITOR COMPLIANCE WITH TERMS AND CONDITIONS FOR LOCAL CURRENCY LENDING PROGRAM</u>	<p><u>BORROWERS:</u> Specifications and restrictions placed on eligible borrowers observed. Target groups being addressed.</p> <p><u>USE OF FUNDS:</u> Specifications and restrictions on use of local currency funds observed.</p> <p><u>REPAYMENT OF LOANS:</u> Loan repayment history and trends reported.</p>	PROJECT MANAGER	Project MIS systems assisted by outside auditors will provide control information. See Annex 5, Special consulting studies also utilized.
5. <u>MONITOR SOURCE AND USE OF FUNDS</u>	<p><u>FOREIGN EXCHANGE:</u> Commitment letters in place, credit lines operative, exporters paid, and confirming/paying bank drawing down against commitment letter.</p> <p><u>GOZ CONTRIBUTIONS:</u> Funds budgeted and released by GOZ as per agreements.</p> <p><u>LOCAL CURRENCY:</u> 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.</p> <p><u>PROJECT RELATED PAYMENTS:</u> All individual and company contractors and suppliers paid on schedule.</p>	PROJECT MANAGER FN Commodity Staff	Close working relationship with mission controller re project related payments. Periodic audits by outside auditors will be scheduled.
6. <u>EVALUATE EFFECTIVENESS OF IMPLEMENTING AGENTS AND CONTRACTORS</u>	<p><u>PERSONAL SERVICES CONTRACTORS</u></p> <p><u>FIDUCIARY BANK</u></p> <p><u>PARTICIPATING BANKS</u></p> <p><u>CONSULTANTS AND AUDITORS</u></p>	PDO PROJECT MANAGER	Periodic evaluation and reporting of performance to mission management with appropriate recommendations.

5
17

Exhibit 4.2 Continued

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

5. SUMMARIES OF PROJECT ANALYSES

This Section provides summaries of Annexes to the Project 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 Project, the MSEs, and possible 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 Project 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, infrastructure 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 in assets; and a 37 company sample of medium sized companies with average employment of 250 and average sales of \$2,760,000.

The small company survey resulted in a number of conclusions:

- o 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.
- o The financing of productive imports - both foreign and exchange and local currency - is a major and chronic problem.
- o The financing of spare parts and access to medium and long term credit for rehabilitation and modernization remain an equally important problem.
- o 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.

- o Capacity utilization averages 49 percent.
- o 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:

- o 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.
- o 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.
- o 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.

- o 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.
- o 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.
- o 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.

- o Lack Of Long Term Resources Banks hold primarily short term demand deposits and avoid mismatching

short term resources with medium or long term credits.

- o High Inflation Rates Negative interest rates resulting from high inflation discourages any form of medium and long term lending.
- o Lucrative Non-Fund Business While banks may be essentially breaking even in their lending activities their real profits come 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.
- o 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.

- o 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.
- o 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.

- o 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.
- o 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.
- o 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

Apart from providing quick-disbursing foreign exchange balance of payments support, 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.

- o 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 CPF.

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.

- o Provide Local Currency Loans To Target MSEs: Local currency generations from the PSSP deposited in the Counterpart Fund 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 three years 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 led 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.

(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:

- o Retrocession of Zairianized and nationalized enterprises to private owners, starting in 1976.
- o Virtual elimination of agricultural marketing parastatals in 1978.
- o Liberalization of interest rates and agricultural and industrial prices in 1981-83 (agricultural interest rates in 1987).
- o Liberalization of the exchange rate and import/export transactions in 1983.
- o 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 Project (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 the private sector directly through financing imports of working materials and investment goods and through financing local costs. The balance of payments relief thus provided will support the continuation of the liberalization and stabilization program and the extension of the structural adjustment program to a series of major measures in 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.

(4) Interest Rates for Private Sector Financing

At regular consultations between AID and the GOZ, project authorities will set the interest rate on project funds lent to the project 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 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 Target Beneficiaries

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

- o 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).
- o The medium scale enterprises surveyed are mostly industries producing consumer goods of primary necessity for local consumption: matches, bricks, paint, wood and metal products, soap, etc. All medium scale companies surveyed are located in Kinshasa.
- o Medium scale companies tend to be owned by expatriates, many of whom are second generation in Zaire. There is some Zairian participation in these companies and all but top executives are Zairian.

- o MSEs are currently experiencing an especially sharp decline in their access to foreign exchange through the banking system.
- o 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) MSEs And Non-Target 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 project 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. 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, 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 under-represented both as owners and employees in the MSEs surveyed for the Project. 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 Project 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 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. The Project 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. Therefore, a project such as the PSSP cannot reach them directly.

Special studies suggested above, funded by the Project, may lead to interventions and policy changes directed toward aiding small-scale and rural-based enterprises. The Project 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 Quick disbursing dollar balance of payments support to the GOZ.
- o Policy reforms and policy dialogue with the GOZ to 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 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.

These four major objectives impose a number of requirements which must be built in to the structure and systems of the PSSP.

- o Active Involvement of USAID's Senior Management in continuing policy dialogue and consultation with the GOZ and the lending and donor community.
- o A Strong Project Management Unit capable of supporting mission management in the policy dialogue process; managing, coordinating, and evaluating the various participating organizations; and preparing periodic and special monitoring and evaluation reports with recommendations for future action.
- o 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, loan, collect and reimburse USAID local currency funds lent to private sector borrowers, and account for and report on these transactions in a manner acceptable to USAID.
- o 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.

- o 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.
- o 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, impact 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.

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

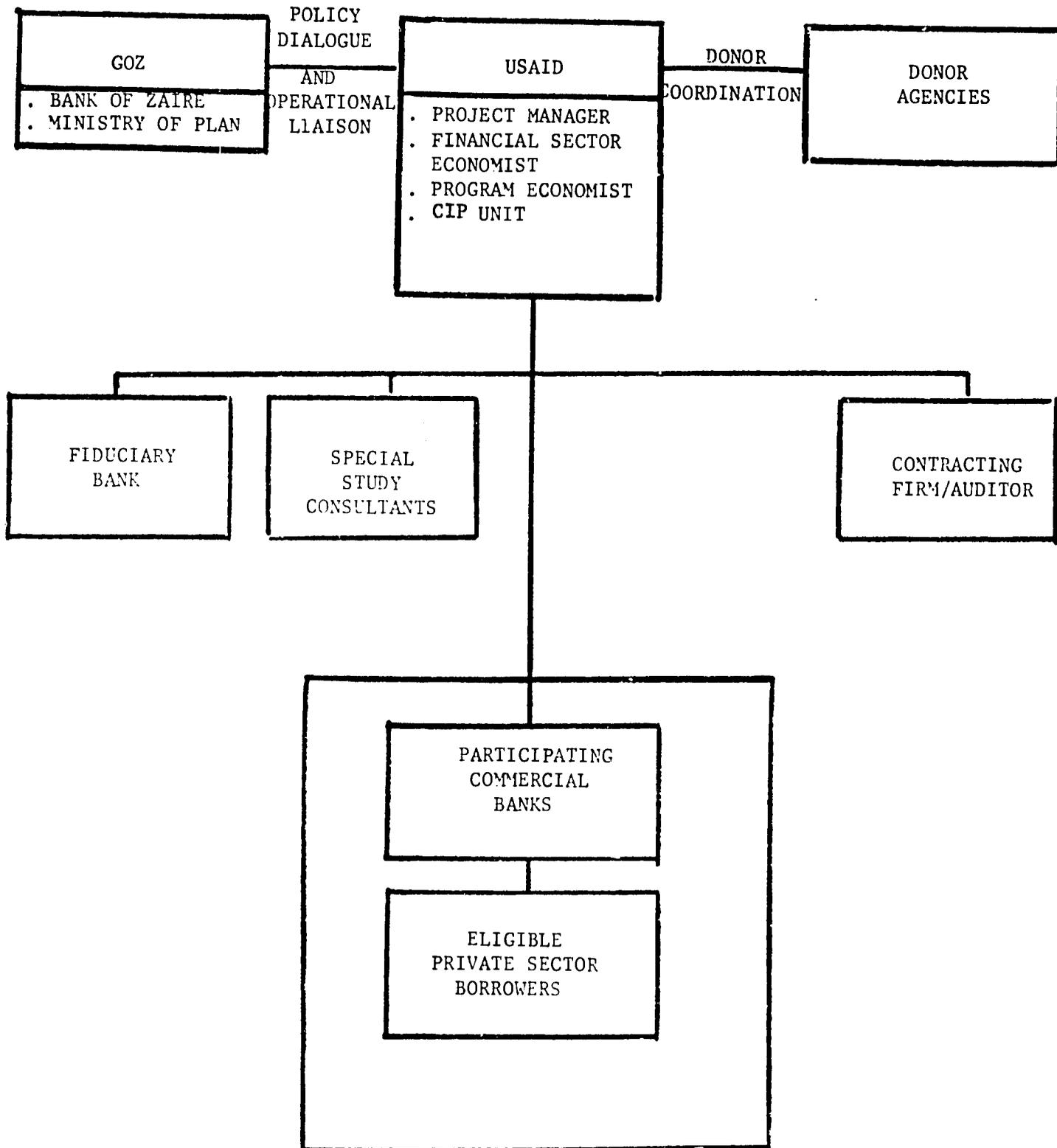
The Project Management Unit (PMU) which reports directly to the PDO Division Chief has been structured and staffed to carry out a full range of planning, research, project management, coordination and control, and monitoring-evaluation-audit functions. It supports senior mission management in on-going 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 Project Manager of the PMU will, as a result, also serve as the mission's Private Enterprise Advisor.

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

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

STRUCTURE AND RELATIONSHIPS
PRIVATE SECTOR SUPPORT PROJECT



- o 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 Project 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 project purpose and goal.

- o The purpose of the PSSP is to support Zaire's Structural Adjustment Program by providing balance of payments support to the GOZ and term credit to the private sector while assisting in the development and implementation of policy changes which will enable commercial banks to expand financial services necessary for the growth of private sector MSEs.
- o 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.

The continuation of the stabilization and liberalization program seeks lower and more stable inflation, while an improved investment and credit environment for financial institutions encourages mobilization of a larger share of national liquidity and its allocation to the private sector.

6.1 Program Monitoring - Benchmarks

A number of guidelines were established to assist in the development of "benchmarks" for monitoring progress in goal and purpose level reforms. 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 "CPs" has been achieved. Guidelines used in developing program benchmarks are to:

- o Have relevance and contribute to specific PSSP goals and objectives.
- o Facilitate the successful operation and management of the project.
- o 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.

- o Have a reasonable chance of being installed and operative over the LOP.
- o Contribute in a coordinated and visible manner to agreed GOZ and donor policy reforms agendas and timetables.
- o Not place onerous burdens on a government with limited capabilities, already attempting to handle a large and diversified menu of policy reforms.
- o 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.

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

6.3 Covenants

(1) 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.

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

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.

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

6.5 Conditions Precedent To Subsequent Releases

AID will obligate funds to the project 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. 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 end of calendar year 1988:

- 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 these objectives 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.

6.6 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.

o 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.

o 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 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.

6.7 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:

- 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.
- 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.

6.8 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 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 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.

6.9 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 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.

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 larger term macroeconomic and socio-economic 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 project. 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.

- o The Government of Zaire which receives dollar balance-of-payment grants in exchange for policy reforms.
- o 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.
- o 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.
- o 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.

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-project goals and objectives, and then determined the intervening needs for monitoring, evaluating, and assessing on a short and long term basis project performance against targets.

o The Current Situation

Baseline data was collected on the current status, activities and performance of all participants. 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.

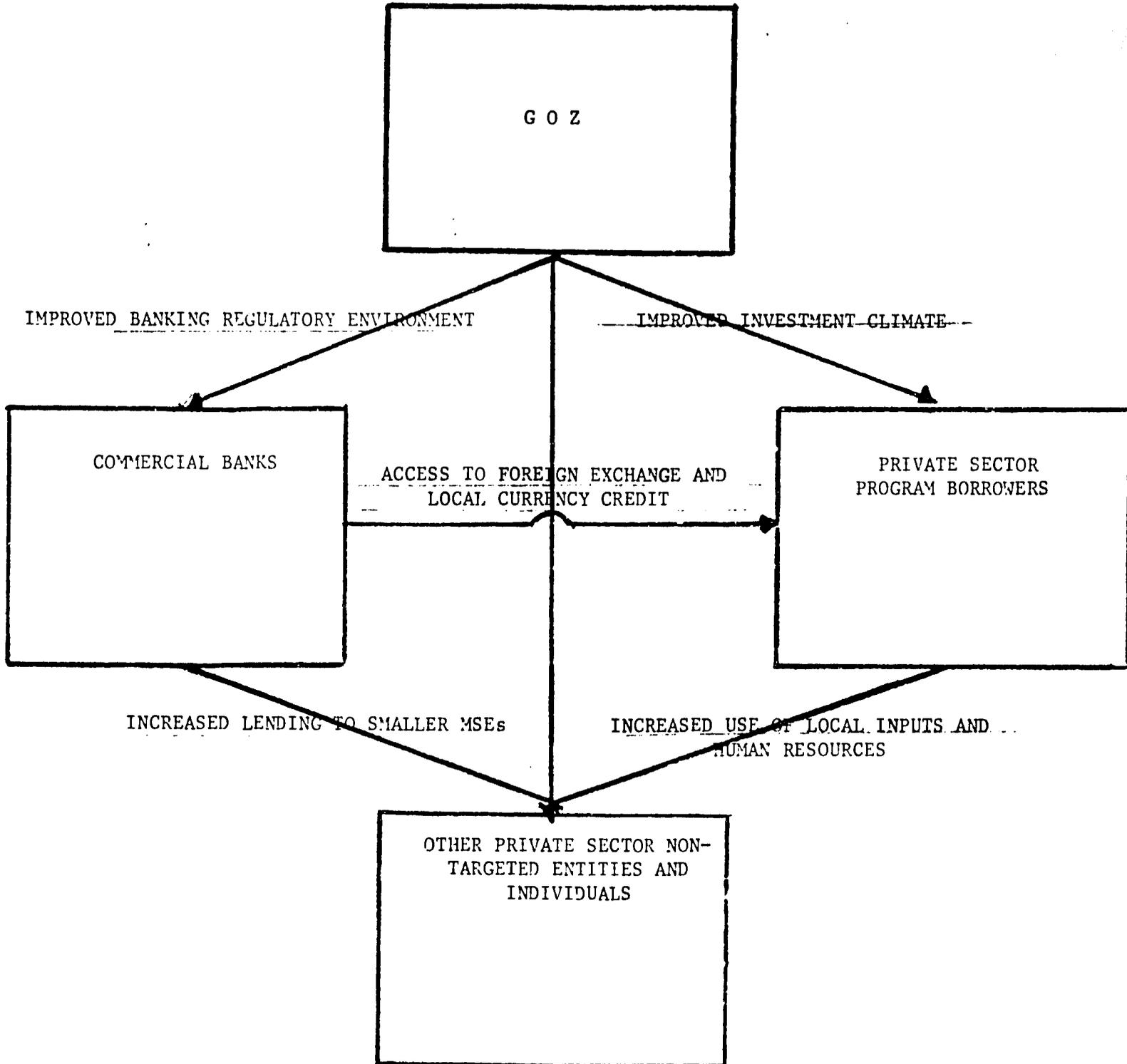
o End Of Project Goals And Objectives

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

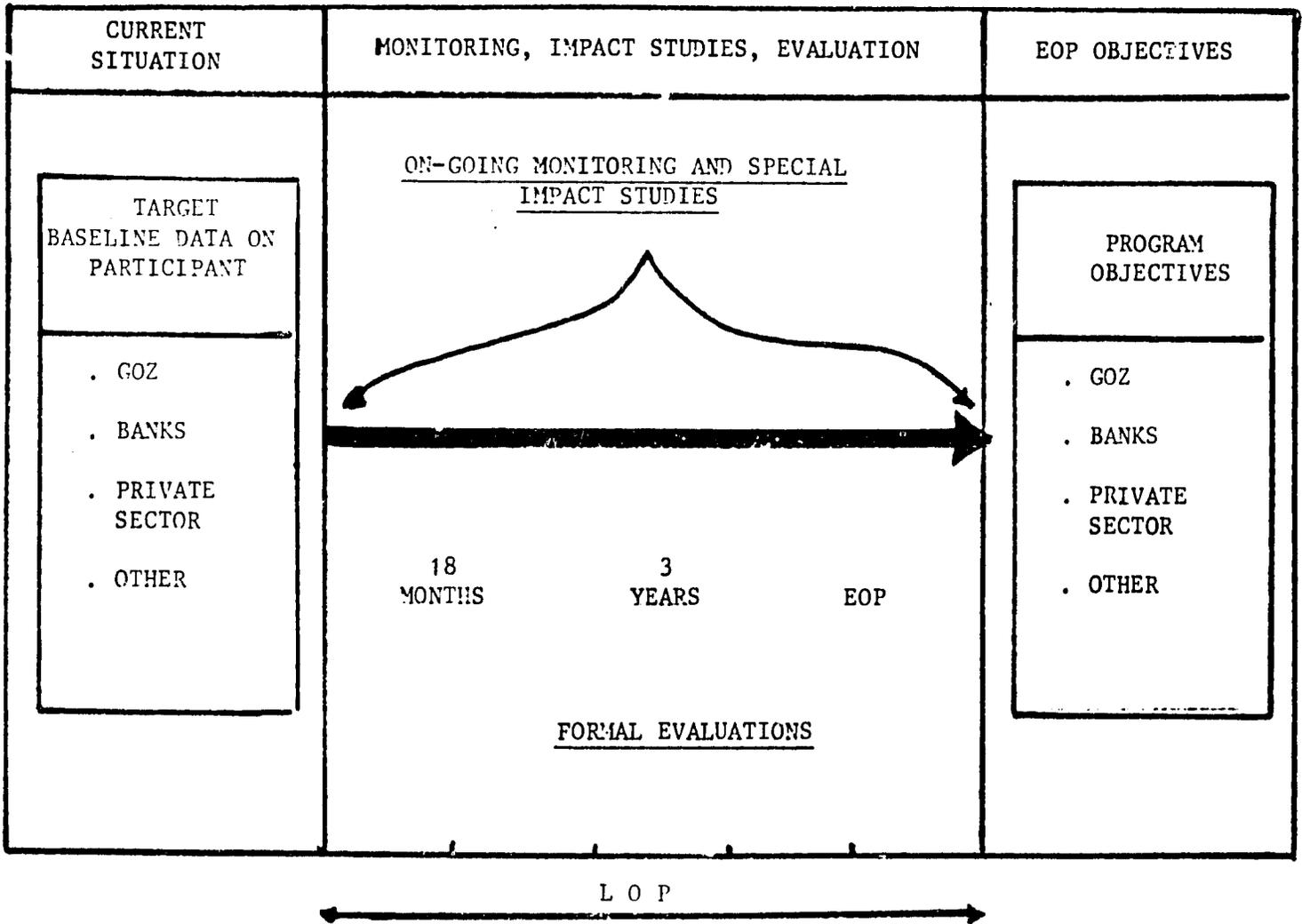
The PSSP design attempts to coordinate in a meaningful way the monitoring, impact and special studies and evaluation programs to satisfy operational, short and medium term and end-of-project assessments of performance and goal-objective attainment. Refer to Exhibit 7.2, Monitoring and Evaluation Overview,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

RELATIONSHIPS AMONG PSSP PROGRAM/BENEFICIARIES



MONITORING AND EVALUATION OVERVIEW

- PRIVATE SECTOR SUPPORT PROJECT -



90x

7.2 The Measurement Of Project Performance.

Project "evaluation" will be an on-going task of the Project 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, project 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: project "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 7.3

MAJOR ELEMENTS FOR MONITORING AND EVALUATION

PRIVATE SECTOR SUPPORT PROJECT

TARGET BENEFICIARY	PSSP INPUT TO BENEFICIARY	PSSP EXPECTED OUTPUT FROM BENEFICIARY	PROGRESS MEASUREMENTS
<u>GOVERNMENT OF ZAIRE</u>	1. <u>\$35 MILLION QUICK DISBURSING GRANT FOR BALANCE OF PAYMENTS SUPPORT</u>	<p>1. <u>POLICY AND REGULATORY REFORMS</u></p> <p>1.1 Publish Financial Development Policy Statement</p> <p>1.2 Maintain liberalization policies re exchange rates, deficits, free interest rates, price liberalization tariffs, and balance of payments.</p> <p>1.3 Take appropriate and timely actions to meet PSSP conditionality benchmarks: incite 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.</p>	<p>1.1 Publication of statement</p> <p>1.2 Declining interest rates, positive real interest rates, reduced deficits price reforms and improvements in balance of payments.</p> <p>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.</p> <p>1.4 Sources: GOZ, IMF, World Bank reports; PSSP monitoring reports; participating and fiduciary bank reports; special consulting and audit reports; evaluations.</p>
	2. <u>TECHNICAL ASSISTANCE TO GOZ FOR FINANCIAL SECTOR REFORM PROGRAM</u>	<p>2.1 GOZ/USAID Consultations on financial sector reform recommendations.</p> <p>2.2 Action plans and timetables prepared for agreed reforms.</p> <p>2.3 Agreed reforms enacted.</p>	<p>2. IMF and World Bank dialogue, monitoring reports, special studies and evaluations.</p>

COMMERCIAL BANKS

- | | | |
|---|---|--|
| <p>1. <u>ACCESS TO \$35 MILLION TO MEET CUSTOMER DEMAND FOR FOREIGN EXCHANGE WITH NO FX RISK AND PROFITABLE TRANSACTION FEE STRUCTURE</u></p> | <p>1.1 Participating banks draw down FX fund for qualified private sector customers on a quick-commitment quick-disbursement basis.</p> <p>1.2 Participating banks review and qualify borrowers and imports against USAID-specified borrower targets, commodity specifications and sourcing requirements.</p> | <p>1. Foreign exchange drawdowns meet USAID-determined disbursement targets. Participating and fiduciary bank reports, monitoring reports, special consulting surveys, and evaluations.</p> |
| <p>2. <u>DELAYED TERM REPAYMENT TO USAID OF LOCAL CURRENCY EQUIVALENT OF FX DRAWDOWNS.</u></p> | <p>2.1 Banks pass on USAID local currency term payment conditions to private sector borrowers.</p> <p>2.2 Banks repay local currency equivalent of fx to counterpart fund on agreed terms and schedules.</p> | <p>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.</p> |
| <p>3. <u>IMPROVED BANKING ENVIRONMENT RESULTING FROM GOZ POLICY AND REGULATORY CHANGES (See 1 above)</u></p> | <p>3.1 Banks expand their local currency deposit and depositor base in real terms.</p> <p>3.2 Banks make longer term loans to smaller private sector borrowers.</p> <p>3.3 Banks realize greater share of the national money supply.</p> <p>3.4 Bank lending portfolios to MSE borrowers are profitable.</p> | <p>3. Trends in mobilization of money supply and loans to MSE borrowers increasing in real terms. Central bank, commercial and fiduciary bank reports, IMF/World Bank reports and statistics, project monitoring and evaluation reports, and special consulting surveys.</p> |
| <p>4. <u>ACCESS TO LOCAL CURRENCY FROM USAID COUNTERPART FUND FOR ON-LENDING TO PRIVATE SECTOR MSEs</u></p> | <p>4. Participating banks increase volume in real terms of term lending to target private sector MSEs.</p> | <p>4. Central bank, participating and fiduciary banks, and project monitoring reports. Special impact and research surveys and evaluations.</p> |

TARGETED PRIVATE
SECTOR MSE
BORROWERS

- | | | |
|--|--|---|
| 1. <u>ACCESS TO FOREIGN EXCHANGE FOR ESSENTIAL COMMODITY IMPORTS ON FAVORABLE REPAYMENT TERMS AND NO FOREIGN EXCHANGE RISK</u> | 1.1 Targeted private sector MSEs have access to FX for critical imports.

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.

1.2 Special surveys by outside consultants, and evaluation reports to measure change. |
| 2. <u>ACCESS TO LOCAL CURRENCY TERM LOANS</u> | 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. <u>INCREASING ACCESS TO LOCAL CURRENCY CREDIT OVER LOP</u> | 1.1 Increasing short and medium term local currency lending as investment climate and banking regulatory environment improves.

1.2 Increased employment opportunities from business expansion of both targeted and non targeted business expansion.

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. |
|---|---|---|

PRIVATE SECTOR -
GENERAL

- | | | |
|---|--|--|
| 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.

1.2 Increased utilization of installed plant capacity results in increases in employment opportunities and higher levels of local inputs.

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. |
|---|--|--|