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ASSOCIATES FOR INTERNATIONAL RESOURCES AND DEVELOPMENT

COSTS AND BENEFITS OF ELIMINATING INSTITUTIONAL CONSTRAINTS ON THE EXPANSION OF NONTRADITIONAL EXPORTS

FINAL REPORT

October 1994

by

J. Dirck Stryker
and
Christopher Shaw

with the assistance of
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EXECUTIVE SUMMARY

Introduction

The purpose of this study is to develop a prototype methodology for identifying priorities regarding the promotion of nontraditional exports and to test that methodology in two African countries, Ghana and Madagascar, that have undertaken significant policy reforms aimed at achieving structural adjustment through outward-oriented incentives and greater emphasis on the private sector. The study identifies and estimates the cost of a number of important institutional constraints on the expansion of the nontraditional exports in which each country has a comparative advantage.

The focus is on this sector for several reasons. First, nontraditional exports are seen as the key to economic growth in most African countries for at least the next two or three decades. Second, the development of nontraditional exports, frequently in cooperation with foreign partners, requires that close attention be paid to the transactions costs associated with property rights, technology transfer, contracts, financing, investment incentives, trade policy, foreign exchange policy, and a host of other areas that can frequently be ignored if production is destined for the domestic market or for traditional export markets. Thus the nontraditional export sector can be seen as key to opening countries up to flows of capital, technology, and institutional innovation, which have proved elsewhere to be vital for economic development.

Background

Most of the sub-Saharan African countries that have undertaken major reforms are moving away from highly distorted incentive structures in which goods and services have been allocated by administrative decisions rather than by markets responsive to relative prices. The reforms have been designed to alter the structure of incentives in the direction of opening the economy to international trade and increasing the relative importance of the private sector. The ultimate goal has been to increase economic growth. Frequently, these economies have been characterized by a dual price structure in which prices on the free market have been much higher than official prices prevailing in the public distribution network. This has given rise to extensive rent-seeking activities to the detriment of more directly productive economic activity. Institutional structures and business procedures, in consequence, have been seriously distorted.

With the advent of reform, opportunities for rent-seeking have diminished and resources are being reallocated towards more productive activities. In the past, these activities have consisted essentially of two types: import-competing production for the domestic market and traditional primary product exports. Opportunities for further growth in these sectors, however, are limited. First, expansion of production for the domestic market is constrained in most countries by its small size. Second, although there is some scope for increasing traditional primary product exports, and perhaps recapturing markets lost to competitors elsewhere in the world, this avenue of growth is blocked by both demand and supply. On the demand side, world market prospects for many of Africa's traditional exports -- e.g., coffee, cocoa, tea, groundnuts, cotton, oil palm products, copper, bauxite, uranium -- are poor. On the supply side, population growth is pressing on the land suitable for livestock and cash crops, and mineral deposits and

forest reserves are being exhausted. In the future, African countries will have to rely increasingly on nontraditional exports as the engine of economic growth.

Whether countries in sub-Saharan Africa can expand their nontraditional exports depends on a number of factors. First is the pattern of comparative advantage that each country has in the production and export of these products. Second is the infrastructure that exists in transport, telecommunications, energy supply, and other areas essential to competitive export activity. Third, there is a need to invest in mechanisms for acquiring information on market opportunities, production technologies, and a number of other areas through the creation of professional and trade associations, the rehabilitation of agricultural research organizations, the upgrading of training and educational institutions, etc. Finally, there is a requirement to define more carefully the role of the public sector and the institutions that surround it.

The development of agricultural and industrial sectors that are capable of competing successfully on world markets requires the establishment and growth of institutions that define the role of the public sector in relation to private economic agents. These institutions include the government ministries, the central bank, and other public agencies involved with trade, investment, and finance. They also include the financial institutions, trading houses, professional associations, and other organizations that play a quasi-public role. Each of these interacts with the private sector through systems of business regulation, customs and tax administration, rules and procedures regarding the allocation of credit and foreign exchange, approvals for tax exemptions and other benefits, regulation of transportation and telecommunications, and a host of other areas. In addition, the legal and judicial system that is best suited to a market economy rests on three basic foundations: property rights, contracts, and torts (extra-contract liability). Ideally, this body of law and regulation serves to reduce transaction costs through streamlining of procedures and increasing predictability of outcomes. It is also possible, however, especially in the developing world, that regulation poses additional barriers to business and trade, whether by intention--to increase equity or meet other social goals--or unintentionally through poor design.

Methodological Approach

The methodological approach used here is an extension of that used in the past to estimate comparative cost and incentive indicators for a number of African countries. The extension of this methodology involves estimating the costs of various institutional constraints. These costs are categorized according to whether or not they may be interpreted as an implicit tax or subsidy on tradable or nontradable goods and services, or, alternatively, whether they are part of the real economic cost of doing business. As an example, long delays in clearing exports or imported inputs through customs have costs that can be measured in terms of unnecessary fees, implicit interest charges, and wasted administrative effort. This acts effectively as a nontariff barrier, which can be converted to its equivalent tax on exports or tariff on tradable inputs.

Country Case Studies

The case studies of Ghana and Madagascar are discussed in Chapters III and IV. Each of these chapters examines trends in nontraditional export growth, by product and market destination, and looks at some of the factors that determine the evolving structure of comparative

advantage. This is followed by a description of the legal, regulatory, and judicial environment, as well as some discussion of infrastructural constraints on nontraditional export growth.

In each country, a survey was conducted of about forty exporting firms, the results of which are presented in these chapters. These results are described first in terms of some basic statistics describing relevant characteristics of the sample of firms. There is also a discussion of some of the more qualitative dimensions of the survey responses. Finally, the results are presented of a series of regression equations used to test a number of hypotheses related to nontraditional export growth.

The next section in these chapters presents the results of the application of the methodology for measuring the costs of institutional barriers to nontraditional exports. This methodology was applied to each firm that provided the more extensive quantitative data required for this analysis. The results are described and are interpreted in the light of the preceding discussion. The final section of each case study chapter presents some implications of the entire analysis for policy, including specific recommendations for each country.

These two chapters provide a wealth of important detail regarding the legal, regulatory, and judicial environment in each case study country and how this environment, as well as other institutional structures, has helped or impeded the expansion of nontraditional exports. It is impossible to do justice in this summary to this discussion. Instead, we focus below on the comparative analysis made on the basis of the case studies and on the conclusions and recommendations of the final chapter.

Comparative Analysis

Most of the comparative analysis relates to the institutional environment that exists in Africa and the kinds of distortions in incentives that it creates. These distortions must be considered, however, in relation to the kinds of products that are being exported and the evolving nature of Africa's comparative advantage. They must also be seen within the light of the demands placed upon exporters by today's competitive world markets and the bias against exports inherent in most African economies.

Africa's Evolving Comparative Advantage

For many years, Africa's comparative advantage has been seen as being based principally on traditional primary products. This is because the natural resources used to produce these products were thought to be abundant relative to supplies of labor and capital. Although this dimension of comparative advantage is far from exhausted in most African countries, in others the prospects for this sector serving as the motor of growth in the future are dim. In some instances, this is because world market opportunities are limited; in others, demand constraints are less important than those of supply.

At the same time that the prospects for traditional export growth are declining for many African countries, there are new opportunities in the area of nontraditional exports. One example is the growth of demand in the richer nations for tropical fruits and vegetables, which now

occupy a special section in many supermarkets. Another is the expansion in the marketing of Afrocentric products to include a number of department store chains. Third, though exports of timber are declining in many countries because of supply constraints, those of processed wood products are rising because of ready access to cheap labor and raw materials and because demand for high quality hardwood furniture, builders materials, and other products is rising. Finally, a number of African countries are beginning to be taken seriously as sources of cheap, but efficient, labor for the production of standardized products, such as garments, that are produced using labor-intensive techniques.

There are several hypotheses that can be generated to analyze a country's comparative advantage. The first is that most countries have a comparative advantage in a number of different types of nontraditional exports based on ecological and geological conditions, pools of low cost labor, rich cultural history, proximity to neighboring markets, and other elements. Very often the absence of one element underlying a country's comparative advantage implies the presence of other elements. In Madagascar, for example, the areas that are particularly rich ecologically produce the spices, tropical fruits, medicinal plants, seafood, and other natural resource based products that are exported, while the labor used in the production of garments comes primarily from the highlands, where population pressure on the resource base is high and wages are low.

A second hypothesis is that most African countries have products that they can export for which comparative advantage is sufficiently high that they do not have to be extremely competitive on world markets. This is particularly true of the products for which comparative advantage is based on ecological or geological conditions or on cultural history. These are the products that the firms of a country can export while they are learning to become more competitive in terms of their packaging, quality control, and timeliness. With their competitive edge assured by geography or history, they can afford to make some mistakes during this period before they embark on the more difficult standardized products for which competition is much keener.

Competition in Today's World Markets

As the world economy becomes more integrated and demanding, countries must compete with each other not only in terms of price but also in terms of quality and timeliness. In today's competitive market, lower price is not as easily substituted for lower quality as in the past. Legislation and the trend toward standardized products have made quality control an important element in buyers' decisions. African firms need to implement management measures that will guarantee the quality of their goods. This task should not be the sole responsibility of the individual firms, but due to its externalities, of the professional associations and other quasi-public groups as well.

Timeliness is also increasingly important in satisfying importer's needs. Just-In-Time (JIT) manufacturing methods are increasingly being utilized, which means rapid and reliable telecommunications and reduced transportation time. Buyers are interested in moving stock quickly -- instead of having a 6-week stock, now they only want 1.5 weeks worth. This

translates into suppliers having to make more frequent and smaller shipments, increasing the burden placed on telecommunications and transportation infrastructure.

Bias Against Exports

Exploitation of Africa's evolving comparative advantage in nontraditional exports is seriously impeded today by the strong bias that exists against exports. This bias occurs for two major reasons. The first is overvaluation, which creates a bias against exports in favor of nontradables. The second, somewhat related, bias occurs because import taxes tend to protect the import-competing sector, attracting resources towards this sector and away from the production of exports. Both the bias due to overvaluation and that which occurs within the tradables sector are, to a large extent, unintended by-products of taxes imposed primarily for revenue purposes. Yet it is difficult to reduce these taxes because governments in Africa do not have the administrative capacity to rely more heavily on direct taxes as a major source of revenue.

Subsidies and other measures to promote exports could be used to offset these biases. Even in the absence of the biases, a strong case can still be made for the active promotion of nontraditional exports based on the important benefits that may be derived by African nations from expanded international trade. The evidence continues to mount from other parts of the world, as well as from the experience within Africa, that economic growth is closely interlinked with foreign trade. Aside from the usual economic arguments associated with efficiency of resource allocation due to the exploitation of comparative advantage and economies of scale, there are a number of other ways in which trade contributes to economic growth. These include using trade and associated investment as a conduit for technological transfer, increasing the efficiency of enterprises forced to compete on foreign markets, expanding the commercial and managerial competence of entrepreneurs, augmenting the skills of the work force, creating a market for labor in the face of growing population pressure, increasing foreign exchange earnings that can be used to import capital equipment, and a host of other factors.

Assuming that trade is desirable, the question remains as to whether the benefits from trade accrue equally regardless of whether exports, especially nontraditional exports, are directed at overseas markets or to neighboring countries. The data gathered from the surveys in Ghana and Madagascar throw some interesting light on this issue. Although firms with a larger value of total sales contribute the most to nontraditional exports, they do not represent the most dynamic element in the export sector. Instead, it appears that smaller, younger firms are more heavily specialized in exports and are more likely to find niche markets in the industrial countries, rather than simply expanding into neighboring countries as the older, larger firms have done. Ways should be found to facilitate linkages between these younger firms and foreign partners, which could play a vital role in helping them to penetrate overseas markets.

Legal, Regulatory, and Judicial Environment

The investigations conducted as part of the two case studies suggest that the legal and judicial institutional framework is sorely inadequate. Recourse to the courts is slow, costly, and

unpredictable. Although efforts are underway to reduce government regulation, which is frequently perceived by the business community as being both excessive and arbitrary, the development of a legal and judicial system capable of taking its place is proving to be a very slow process.

Despite the inadequacies of the legal and judicial system perceived by the business community, few firms listed this as a serious constraint on the expansion of nontraditional exports. Instead, they have found ways of working around the system that involve personal relationships, family and school ties, political favoritism, and even outright bribery. Although this reduces the problems normally resolved in the advanced countries through the application of law, it has two important consequences. First, it reduces the scale of activities by preventing the emergence of complex impersonal forms of exchange. Second, it severely biases the incentive structure in favor of the rich and powerful, preventing the emergence of less advantaged, but potentially dynamic, smaller entrepreneurs.

Institutional Distortions: Conclusions and Recommendations

In addition to the limitations and biases imposed by the lack of a viable legal and judicial environment in most African countries, there are a number of important distortions in the institutional structures of these countries that are inhibiting the expansion of nontraditional exports. A comparison of the institutional environments in Ghana and Madagascar reveal some important similarities, despite their varied colonial histories, but there are also substantial differences. The major constraints imposed by these environments on the expansion of nontraditional exports tend to be quite similar. These include (1) restrictions on exporters' retention of foreign exchange earnings, (2) lack of duty-free access to imported inputs, (3) slow and costly procedures for clearing exports and imported inputs, (4) lack of access to term finance for fixed investment, (5) lack of access by smaller firms to working capital, (6) problems in the implementation of special incentive schemes, (7) lack of competition for air and sea freight, (8) inadequate transportation and telecommunications, (9) excessively complicated or restrictive regulations regarding land and labor, (10) lack of qualified skilled labor and middle-level managers (11) and problems in contract enforcement with overseas importers.

Restrictions on Exporters' Retention of Foreign Exchange Earnings: Historically, the most important disincentive to exports, traditional as well as nontraditional, has been overvaluation of the exchange rate. In addition, where exchange controls are in place, with exporters required to turn their foreign exchange earnings in to the banking system or exchange authority rather than being allowed to retain these earnings or to exchange them for local currency on the private market, the potential for an export disincentive exists. The severity of this disincentive depends on the difference between the rate at which exchange conversion takes place through the official, regulated market and the rate that exists on the private, parallel market that is found both within the country and offshore.

Given the biases against exports that are unavoidable, because of the need to raise public revenue by taxing imports, it is imperative that exporters be given every encouragement possible. Where countries such as Ghana and Madagascar have moved their exchange rates to realistic

levels and have in place mechanisms to make swift exchange rate adjustments, there is nothing to be gained by maintaining controls on exporters' earnings of foreign exchange. These should be totally eliminated. Experience has shown that this does not result in a massive flight of capital. Rather, exporters are encouraged to repatriate their foreign exchange earnings in order to pay their recurrent cost obligations and finance new investment.

Lack of Duty-Free Access to Imported Inputs: Both Ghana and Madagascar suffer from lack of duty-free access to imported inputs despite the fact that each has formal mechanisms to provide this access. The cost of not having duty-free access to imported inputs is considerable, especially for the firms that engage in the labor-intensive production of standardized goods made mostly of imported materials, such as the garment industry. The nominal rate of protection (NRP) on inputs for the firms in the survey ranged from 5% to 39% and 2% to 49%, for Ghana and Madagascar respectively. This factor alone resulted in an effective rate of protection (ERP) in Ghana ranging from -4% to -30% and an ERP in Madagascar of from 0% to -21%. Given the competitiveness that exists in world markets, especially for standardized products, and given the other biases against exports described above that are largely unavoidable, this level of negative protection resulting from taxation of inputs is intolerable if African countries are to succeed in expanding their nontraditional exports.

Procedures for granting duty-free access to imported inputs must be made more automatic, must reduce the discretionary authority of public officials, and must eliminate the bias in favor of large firms and firms that export most of their production. Fortunately, this is becoming increasingly possible as customs processing is becoming more computerized.

Slow and Costly Procedures for Clearing Exports and Imported Inputs: In each of the case study countries, exporters listed slow and costly procedures for clearing exports and imported inputs as a significant problem, despite the fact that major strides have been made in recent years in simplifying these procedures. One problem is that clearance of goods through customs becomes a convenient way of assuring that companies have complied with legal and tax obligations that have nothing to do with their trade activities. Another major problem is the special authorizations required from technical ministries before exports are allowed to clear customs. This problem is often further exacerbated by the lack of coordination between customs and the technical ministries.

Detailed recommendations are presented in the case studies regarding the elimination of unnecessary export procedures. Approval of technical ministries should be required only to assure that health and safety standards are adhered to, as is the case with food products. Every effort should be made to publicize widely the requirements that exist and to assure that these are as simple as possible. Computerization is essential to speed the process. It may also be necessary to hire more customs agents.

Lack of Access to Term Finance for Fixed Investment: Lack of access to term finance for fixed investment was cited by exporters in both countries as a major constraint on the expansion of nontraditional exports. The major reason for lack of term finance is the poor state of development of each country's financial markets. These markets have evolved from a history of inflation, poor banking practices, and general economic malaise, which has made banks and

other financial institutions highly risk averse. Furthermore, neither of these countries has yet established a macroeconomic environment that is sufficiently stable with respect to prices, interest rates, and exchange rates to reduce to reasonable levels the actual risks associated with term finance. Finally, the legal and judicial system functions so poorly that lenders have an extremely difficult time foreclosing on delinquent borrowers. As a result, commercial banks and other lending institutions have preferred to confine themselves to lending working capital and to the purchase of relatively safe, and often high-yielding, government securities, leaving exporters dependent on their own sources of finance, which are generally quite limited.

Over the longer run, a market for term finance will develop spontaneously in Africa as financial systems become stronger and deeper. It is unclear how much this process can be accelerated without substantial subsidization, which most African countries cannot afford. Nevertheless, there may be ways in which term financing can be facilitated through the exploitation of economies of scale and diversification involved in such activities as leasing, insurance, and loan guarantee. These financial innovations should be strongly supported. In the final analysis, however, the most effective way for governments to encourage the development of a market for term finance is through the maintenance of macroeconomic stability. Low rates of inflation, positive real rates of interest, and a stable exchange rate reduce the risks associated with financial intermediation and help to assure the financial viability of borrowers, making term finance more attractive to lending institutions.

Lack of Access by Smaller Firms to Working Capital: Although few firms listed lack of access to working capital as a major impediment to the expansion of exports, it is clear that this poses problems to smaller firms, many of which have had relatively little banking experience. Shipments by these firms are often relatively small, making it expensive to cover the cost of obtaining letters of credit. Given their lack of credit experience, loans to these firms are considered risky, but the backing of these loans with collateral is difficult because of their lack of financial assets, problems with control of inventories, and legal difficulties in foreclosure on real property.

Insurance and loan guarantees may also play a useful role in helping small firms to gain access to short-term credit for working capital. Equally important, these firms need assistance in establishing banking relations, filling out loan applications, setting up accounting systems, and learning about other commercial and financial practices that are required if they are going to enlarge their scale of export operations. Frequently, this type of assistance can be incorporated into projects for the promotion of nontraditional exports.

Problems in the Implementation of Special Incentive Schemes: Both Ghana and Madagascar make extensive use of special incentive schemes for the promotion of investment. Yet experience with these schemes has not been uniquely favorable. Because the schemes establish a separate set of incentives for firms that are approved under them compared with the tax and other incentives that are available to all firms, the institutions responsible for policing these programs have tended to take on a regulatory role rather than one that is essentially promotional. Furthermore, obtaining approvals under these schemes can be long and time-consuming, and there is often a degree of arbitrariness to the decisions that can lead to abuse.

One of the most disturbing aspects of these schemes is that in practice, if not in principle, they are often biased in favor of foreign investment.

The trend in both Ghana and Madagascar is towards making special incentive schemes such as the investment code or *Zone Franche* more promotional and less regulatory, simplifying and accelerating the approval process, and providing benefits after, rather than before, requirements have been met. The next step would be to incorporate these incentives directly into tax and other codes so that they would be available to all firms that met the requirements rather than just those that are approved. Most important, this approach would eliminate most of the discretionary authority involved in the approval process and would reduce the bias that exists against smaller, local firms.

Lack of Competition for Air and Sea Freight: Many of the overseas transportation problems that Africa faces today result from lack of competition for air and sea freight. Much of this is due to the low volume of export activity, which prevents freight companies from bidding actively against each other on both freight charges and shipment delays. On the other hand, lack of competition can also be engendered by government regulation. The most obvious example is the state monopoly conferred on Air Madagascar/Air France in the shipment of air freight. This results in prohibitively high air freight rates for many exporters, leading to unused capacity and missed market opportunities.

While little can be done about the lack of competition for air and sea freight that results from the low volume of export activity, legal monopoly on domestic and international operations should be eliminated and open competition should be encouraged, including the use of private air cargo planes as soon as the volume of activity makes this profitable.

Inadequate Transportation and Telecommunications: The importance of timeliness and quality control in today's export market was emphasized above. The ability to assure these depends very much on a country's transportation and telecommunications infrastructure, and unfortunately, most African countries do not have adequate transportation and telecommunications infrastructure to meet this requirement. As a result, importers are reluctant to place orders with exporters that they perceive as being less than fully reliable. This is already a problem for exporters of primary resource based and Afrocentric products. It will become even more acute as exports expand of standardized products, for which timeliness and quality control are especially important competitive elements.

Although this report is not concerned primarily with infrastructure, it is evident that poor transportation and telecommunications not only increase costs but also have an important institutional consequence in that they limit a country's ability to respond to the exigencies of today's world markets, which require good timing and quality control. As a result, one cannot stress too much the importance of dealing with these problems as quickly as possible.

Excessively Complicated or Restrictive Regulations Regarding Land and Labor: The two country case studies highlight the cumbersome and complex regulations that exist regarding the use of land and labor. Land registration is often made complicated by the juxtaposition of customary and modern systems of land tenure. The failure to comply with all registration

requirements can be extremely costly and long delays are frequent. Although most firms in the surveys did not cite problems with land registration as being very important, there are enough instances in which they have been important that there is a need to take action. Often what is needed is explicit simplified legislation and then widespread publicity of the various steps that must be taken to register land.

Both domestic and foreign-owned firms in Ghana must go through the Ministry of Labor for recruitment of personnel, rendering the hiring process lengthy and uncertain. Retrenchment of workers must be negotiated with unions and powerful political groups, often making it a very difficult process. Many companies in both Ghana and Madagascar skirt the labor regulations by hiring mostly temporary labor. Though the requirements are not being complied with, their existence may make firms reluctant to hire new workers. It would be preferable, therefore, to liberalize substantially the hiring and firing of labor so as to enable firms to rid themselves of unproductive workers and to adapt flexibly to changing economic circumstances.

Lack of Qualified Labor and Middle-level Managers: Lack of qualified semi-skilled labor and middle-level managers is a perennial problem in countries such as Ghana and Madagascar, which are embarking on the production of new products for export. Government technical schools are not generally a good solution to this problem because the training provided by them is often not what is needed. It is better if the training can be undertaken by the private sector.

Means should be sought for governments to support the private sector in its training of labor and middle-level managers for the nontraditional export sector. This support could take the form of tax credits to individual firms where the training would carry benefits that the firm is not able to capture fully. Alternatively, the public sector could join with professional associations in developing training programs at the industry level.

Problems in Contract Enforcement with Overseas Importers: A number of firms complained about occasional problems in the enforcement of contracts with importers overseas. This was particularly true in the horticultural industry, where exports are frequently made on consignment due to the perishable nature of the product. It is often difficult for a firm to dispute an importer concerning the poor condition of the product on arrival and the consequent discount made on the payment to the exporter.

Problems of contract enforcement are common in international trade and institutional means exist to overcome them. One of the most common solutions is to engage the services of a reputable surveyor to assess damages. This is often done by the importer, with the surveyor's report made available to the exporter.

Research Conclusions and Recommendations

Research Conclusions

From this research, it can be concluded that it is possible to measure quantitatively some of the costs associated with institutional barriers to the expansion of nontraditional exports and that these costs are considerable even in countries that have undertaken fundamental economic reform. The costs that were successfully measured in Ghana and Madagascar are those related to (1) controls on exporters' use of foreign exchange earnings, (2) lack of workable procedures for duty-free admission of imported inputs, and (3) unnecessary administrative delays and procedures involved in the clearance of exports and imported inputs. These costs were generally measured as being equivalent to a tax on exports or to an import tariff. The impact of these costs on nontraditional exports was measured through the change in value of both the domestic resource cost (DRC) of the product and its effective rate of protection.

The net effect of these costs is very substantial for many firms. For many firms, the DRC improves considerably when account is taken of unnecessary institutional costs, suggesting an even stronger comparative advantage for these firms than previously supposed. An unweighted average of effective rates of protection resulting from these costs equals -18.8% in Ghana and -18.6% in Madagascar. This is a very high rate of negative protection for firms trying to compete in the world's export markets, even before taking into account the additional bias against exports resulting from overvaluation of the exchange rate and positive protection for the import-competing sector. Thus application of the methodology to even this limited range of institutional barriers reveals their importance.

There are a number of other costs associated with institutional constraints that have not been measured. These include lack of access to capital, problems in the implementation of special incentive schemes, lack of competition for air and sea freight, effects on quality and timeliness resulting from inadequate transportation and telecommunications, excessive regulations regarding land and labor, lack of qualified labor and managers, and problems in contract enforcement with overseas importers. There is also the larger issue of the weak legal and judicial systems that characterize the entire African continent.

The reasons for the difficulty in measuring the costs associated with these constraints are several. In some instances, such as lack of access to capital, it is not clear how much the problem is due to fundamental factors related to development and how much it is due to impediments amenable to policy change. In other instances, such as the problems linked to special incentive schemes and to the regulation of land and labor, not only are the costs difficult to measure but also it is hard to determine to what extent these costs impede the expansion of nontraditional exports. Finally, as with the problems of contract enforcement reported by exporters, it is not always clear to what extent real costs are involved or there is simply the need for better information.

Despite these limitations, the research methodology is sufficiently developed that it can be extended fairly easily to other African or, for that matter, non-African countries. The methodology helps identify the major institutional constraints on the expansion of nontraditional

exports and estimates the quantitative importance of the costs associated with those constraints. Conclusions can be drawn as to what policy changes can be implemented in the short to medium term, as well as what longer term impediments to trade need to be resolved.

Research Recommendations

In order to improve the effectiveness of these studies and to sharpen the recommendations arising out of them, there are a number of research topics that need to be pursued.

· **Areas of Comparative Advantage.** Further work is needed to identify areas of comparative advantage for African countries related to nontraditional exports. Research needs to be undertaken to identify these products, to assess Africa's comparative advantage in producing and exporting them, and to see what institutional constraints inhibit the exploitation of this advantage.

· **Overseas versus Regional Markets.** An important issue is the advantages and disadvantages associated with exporting to overseas versus regional markets.

· **Controls on Exporters' Earnings of Foreign Exchange.** There is a great need to study the types of controls that governments place on exporters' earnings of foreign exchange and the costs that these impose. Of special concern is the extent to which controls exist today within the CFA zone, where these countries are trying to maintain a fixed exchange rate at a new devalued level.

· **Duty-Free Admission of Imported Inputs.** High priority must be assigned to the establishment of mechanisms for the duty-free admission of imported inputs used in the production of exports. An assessment should be made of how increased computerization of the customs service can create opportunities for innovations that were not possible when all processing and record-keeping was done manually.

· **Improved Access to Finance.** A number of efforts are underway to increase the availability of finance to the export sector for both fixed investment and working capital. These efforts include innovations involving leasing, insurance, and credit guarantees. They need to be monitored and their results evaluated.

· **Special Incentive Programs.** Some countries in Africa are beginning to experiment in their use of special incentive programs designed to encourage investment and exports. These experiments need to be monitored closely to see how well they work and can be applied elsewhere.

· **Quality Control and Timeliness.** Quality control and timeliness are likely to become increasingly important features of competitiveness in international trade. The ability to achieve these depends critically on good transportation and telecommunications, but where these are lacking, research needs to be conducted regarding the options and priorities for investment.

· **Contract Enforcement**. Research is needed to identify the standard procedures used throughout the world for enforcement of international contracts and how they may apply to African exporters.

· **Legal and Judicial System**. The legal and judicial systems in Ghana, Madagascar, and most other African countries, are slow, costly, and uncertain. Yet exporters do not indicate that this is a major problem, possibly because they have found informal means of conducting their business. However, while the lack of such a system may not be much of a problem today, it is likely to become an increasingly important constraint in the future. This hypothesis needs to be tested and an assessment needs to be made as to when this constraint is likely to become binding.

· **Measures to Promote Exports**. Given the strong bias that exists against nontraditional exports, it is important to investigate ways in which this bias might be offset by active measures to promote exports. A number of these measures have been used in Asia, including credit subsidies and guarantees, income tax deductions, accelerated depreciation, special rates on public utilities, and marketing assistance. While it is often argued that Asian conditions are so different with respect to the quality of the civil service, the ability of governments to finance subsidies, and other areas that the lessons of Asia have little relevance for Africa, this assumption needs to be examined carefully, especially if comparisons are made with Southeast Asia rather than East Asia, which is relatively more advanced.

I. INTRODUCTION

This report presents the results of a study of the costs and benefits of eliminating institutional constraints on the expansion of nontraditional exports. The study was conceived by Associates for International Resources and Development in collaboration with the Office of Analysis, Research and Technical Services of the Africa Bureau, U.S. Agency for International Development, which provided funding for the study as part of Contract PDC-0095-Z-00-9053 (Consulting Assistance on Economic Reform).

The purpose of the study was to develop a prototype methodology for identifying priorities regarding the promotion of nontraditional exports and to test that methodology in two African countries that have undertaken significant policy reforms aimed at achieving structural adjustment through outward-oriented incentives and greater emphasis on the private sector. The study was to identify, measure the importance of, and estimate the costs and benefits of eliminating the constraints on the expansion of the nontraditional exports in which each country has a comparative advantage.

The methodology was elaborated in an initial document published in March 1993.[1] This document inventoried a long list of potential constraints related to the legal, regulatory, and judicial (LRJ) environment. This list was gleaned primarily from the papers and reports of economists and lawyers concerned with the institutional issues related to the LRJ environment. The discussion of these potential constraints is reproduced here as Annex A.

The second part of this report outlined a methodology for measuring the costs associated with institutional constraints. This methodology was an extension of the analysis of comparative costs and incentives that calculates indicators of domestic resource costs and nominal and effective rates of protection. The methodology was tested in Ghana and Madagascar, two countries that have undertaken substantial policy reforms designed, in part, to stimulate their nontraditional export sectors.

The results of these tests were reported in two country case study reports.[2] These reports were discussed in June 1994 with the AID missions, host country governments, and representatives of the business and professional community. Comments resulting from these discussions have been incorporated into the final report, which has also been updated to reflect important policy changes that have taken place over the past year and one half.

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[1]J. Dirck Stryker, *et al*, *Costs and Benefits of Eliminating Institutional Constraints on the Expansion of Nontraditional Exports - A Prototype Methodology*, Cambridge, MA: Associates for International Resources and Development, March 1993.

[2]J. Dirck Stryker, *Costs and Benefits of Eliminating Institutional Constraints on the Expansion of Nontraditional Exports - Ghana Case Study*, Associates for International Resources and Development, May 1994; Christopher L. Shaw, J. Dirck Stryker, and Louis Aucoin, *Costs and Benefits of Eliminating Institutional Constraints on the Expansion of Nontraditional Exports - Madagascar Case Study*, Associates for International Resources and Development, June 1994.

The next chapter of this report provides a statement of the problem and a brief discussion of the methodology used to measure the costs associated with institutional constraints. The details regarding the methodology are presented in Annex B. The third and fourth chapters present the two country case studies, and the final chapter compares the results of these case studies, draws some broader policy conclusions, assesses the usefulness of the methodology, and provides recommendations for future research.

II. BACKGROUND

A. Statement of the Problem

A number of countries in sub-Saharan Africa have undertaken major policy reforms over the past one and one-half decades. These have often comprised some combination of (1) devaluation, (2) movement towards a more flexible exchange rate, (3) easing or elimination of foreign exchange controls, (4) reduction or elimination of export taxes, (5) easing or elimination of import controls, (6) reduction in the magnitude and variability of import tariffs, (7) privatization or reform of government parastatals, (8) elimination of price controls and restrictions on private marketing, and (9) reduction of public sector employment. The reforms have been designed to alter the structure of incentives in the direction of opening the economy to international trade and increasing the relative importance of the private sector. The ultimate goal has been to increase economic growth.

Most of the countries that have undertaken major reforms are moving away from highly distorted incentive structures in which goods and services were allocated by administrative decisions rather than by markets responsive to relative prices. Frequently, these economies were characterized by a dual price structure in which prices on the free market were much higher than official prices prevailing in the public distribution network. This gave rise to extensive rent-seeking activities to the detriment of more directly productive economic activity. Institutional structures and business procedures, in consequence, were seriously distorted.

With the advent of reform, opportunities for rent-seeking have diminished and resources are being reallocated towards more productive activities. In the past, these activities have consisted essentially of two types: import-competing production for the domestic market and traditional primary product exports. Opportunities for further growth in these sectors, however, are limited. First, expansion of production for the domestic market is constrained in most countries by its small size. Second, although there is some scope for increasing traditional primary product exports, and perhaps recapturing markets lost to competitors elsewhere in the world, this avenue of growth is blocked by both demand and supply. On the demand side, world market prospects for many of Africa's traditional exports -- e.g., coffee, cocoa, tea, groundnuts, cotton, oil palm products, copper, bauxite, uranium -- are poor. On the supply side, population growth is pressing on the land suitable for livestock and cash crops, and mineral deposits and forest reserves are being exhausted.

In the future, African countries will have to rely increasingly on nontraditional exports as the engine of economic growth. A few countries have already begun to diversify their exports away from traditional commodities. Kenya, for example, has witnessed a major expansion of horticultural exports. Mauritius has moved from heavy reliance on sugar towards export of a range of manufactured goods. Madagascar has experienced growth of a number of nontraditional exports from both primary and secondary sectors, e.g., shrimp, butter beans, medicinal plants, meat, leather, cotton cloth, and garments. Ghana has witnessed rapid growth in exports of Afrocentric products such as cloth, garments, fashion accessories, household furnishings, and

handicrafts.[3] Nigeria has been exporting manufactured goods to the West African market, at least until the recent devaluation of the CFA and the reinstitution of exchange controls in Nigeria. Senegal is exporting labor-intensive products such as footwear to the European market.

Whether countries in sub-Saharan Africa can and should further expand these types of nontraditional exports depends on a number of factors. First is the pattern of comparative advantage that each country has in the production and export of these products. Second is the infrastructure that exists in transport, telecommunications, energy supply, and other areas essential to competitive export activity. Third, there is a need to invest in mechanisms for acquiring information on market opportunities, production technologies, and a number of other areas through the creation of professional and trade associations, the rehabilitation of agricultural research organizations, the upgrading of training and educational institutions, etc. Finally, there is a requirement to define more carefully the role of the public sector and the institutions that surround it.

Most African countries could profitably expand the range of exportable products that they produce. The Gambia, Guinea, Kenya, Madagascar, Mali, Senegal, and a number of other countries, for example, have a climate suitable for growing a wide variety of horticultural products. Other countries have substantial marine resources available for export. Many countries are profitably engaged in the production of primary products, such as cotton and livestock, which could be used as inputs into processing activities. Much of Africa could produce the Afrocentric products for which demand in the industrial world is rapidly expanding. Some countries have the pool of low-wage, semi-skilled labor that could enable them to follow the example of Mauritius in developing labor-intensive, standardized manufactured goods for export.

Africa's comparative advantage in labor-intensive activities is increasing vis-à-vis Asia's. There are several reasons for this. First, rates of population growth are higher, resulting in a rapidly growing labor force. Second, poor economic performance implies that real per capita incomes and wages have been relatively stagnant or even declining in Africa as compared with Asia, where economic growth has been much more pronounced. Finally, in many areas, Africa's population is beginning to press on an extremely fragile resource base. Unless pressure is taken off of these marginal lands through a diversification of employment opportunities, there will be a continuing downward spiral of poverty and resource degradation.

A number of countries that have undertaken major economic reform lack the basic infrastructure to support export-oriented activity. After years of neglect, countries like Ghana, Guinea, Madagascar, and Tanzania need to rebuild, expand, and modernize their roads, ports, airports, telecommunications equipment, and power generating facilities. This is especially

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[3]The potential for trade in Afrocentric products is explored in Tyler Biggs, Gail Moody, Jan-Hendrik van Leeuwen and E. Diane White, "Africa Can Compete! Export Opportunities and Challenges in Garments and Home Products in the U.S. Market," Regional Program on Enterprise Development Discussion Paper, World Bank, 1993.

important for the export trade because of the need for timeliness and flexibility in responding rapidly to overseas demand.

Investment in knowledge and other forms of human capital is also essential. The development of horticulture in Kenya depended on investments in research, training, and extension, yet too many countries have allowed their agricultural research and extension capabilities to deteriorate.[4] Countries, such as Mauritius, that have been successful with nontraditional exports have also had to acquire a knowledge of foreign market opportunities, develop linkages with foreign partners, pay close attention to quality control, and develop a pool of competitively priced semi-skilled labor.[5]

Finally, development of agricultural and industrial sectors that are capable of competing successfully on world markets requires the establishment and growth of institutions that define the role of the public sector in relation to private economic agents. These institutions include the government ministries, the central bank, and other public agencies involved with trade, investment, and finance. They also include the financial institutions, trading houses, professional associations, and other organizations that play a quasi-public role. Each of these interacts with the private sector through systems of business regulation, customs and tax administration, rules and procedures regarding the allocation of credit and foreign exchange, approvals for tax exemptions and other benefits, regulation of transportation and telecommunications, and a host of other areas.

Much of the definition of the relation between public and private sectors is contained within what has often been referred to as the legal, regulatory, and judicial (LRJ) environment. Although this concept extends far beyond the export sector, it is nonetheless crucial to successful export growth.

The legal, regulatory, and judicial environment comprises not only laws and regulations but also machinery for the settlement of disputes, an apparatus for the enforcement of judgements, and a minimum degree of consensus among economic agents as to what constitute rules of the game. Of critical importance is a legal system that is sufficiently insulated from the locus of political authority to permit persons not sharing that authority to have confidence that their rights under the law will be upheld if they follow the rules. This is often not the case in

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[4]Nural Islam highlights the importance for exports of market information, quality control, processing and storage facilities, and agricultural research. He also describes how horticultural exports have served as a natural bridge to exports of nontraditional manufactured goods. See Nural Islam, *Horticultural Exports of Developing Countries: Past Performances, Future Prospects, and Policy Issues*, International Food Policy Research Institute, Research Report No. 80, April 1990.

[5]Foreign firms may play an important catalytic role, here, by providing access to the world market network, the capacity to package exports, and technical, marketing, and management knowhow. World Bank, Industry and Energy Department, and USAID, Bureau for Africa, *Building a Competitive Edge in Sub-Saharan Countries; the Catalytic Role of Foreign and Domestic Enterprise Collaboration in Export Activities*, December 10, 1991.

many developing countries, which discourages investment by those who are not closely linked through family and other ties with those sharing political authority.

The legal system suited to a market economy rests on three basic foundations: property rights, contracts, and torts (extra-contract liability). Building these three foundations requires a supporting legal infrastructure consisting of a judiciary, independent from other branches of government, and lawyers trained to implement the system.

On top of these foundations rests the full legal system which governs the interaction of the public and private sector. For the purposes of this study, the most important part of the system is the body of business law and regulation that deals with such issues as incorporation, bankruptcy, secured transactions, regulation of competition, labor law, and environmental regulation. Regulation of business may extend to such areas as licensing and concessions, financial market regulation, price regulation, and intellectual property. Business regulation pertaining primarily to the functioning of private markets may be distinguished from regulation relevant to public sector concerns, including taxation and monetary control.

Ideally, this body of law and regulation serves to reduce transaction costs through streamlining of procedures and increasing predictability of outcomes. It is also possible, however, especially in the developing world, that regulation poses additional barriers to business and trade, whether by intention--to increase equity or meet other social goals--or unintentionally through poor design.

Just as a legal infrastructure is required to support and enhance the functioning of a system of property rights, contracts, and torts, so is an infrastructure required to operate the system of business regulations, whether pertaining to the private or public sector. Such a system requires for its maintenance a cadre of specialized administrative and agency personnel and trained lawyers in order to ensure the legal functioning of government and the compliance of private parties with existing business regulation.

Finally, quite apart from the realm of private business actors, public agents, and the bodies of law that pertain to their interaction, lies a group of private institutions geared toward reducing further the transaction costs of commerce. This institutional group includes all of those services that exist to expedite the interaction of private commercial actors, and ranges from banks to stock exchanges, from insurance companies to trading houses. A distinct structure of laws, rules, and expectations governs this group of private institutional actors, who necessarily overlap with actors in both the private and public sectors.

Even though policy reforms in recent years have diminished the relative importance of ministries and other agencies of government, these institutions nevertheless play a vital role in implementing the laws and regulations which govern the private sector. Major issues relate to the capacity of these institutions for effective implementation and the potential that exists for abusive use of discretionary authority. Though laws and regulations designed to achieve social goals, such as those involving conditions of employment, might be quite laudable, the economic distortions that they introduce may easily make society worse off than if the laws and regulations had never existed.

How these various actors and institutions develop is the focus of a growing body of literature relevant to the problems facing many developing countries in sub-Saharan Africa. Douglass North has written extensively on the importance of the development in northern Europe of private sector institutions that were conducive to the process of industrialization and the expansion of market exchange. These institutions reduced transactions costs enormously by (1) increasing the mobility of capital, (2) lowering information costs, and (3) spreading risks. This was done through innovations in financial intermediation, accounting, insurance, management, contract enforcement, mercantile law, and other areas. Equally important, limits were established to arbitrary intervention by government in the market place at the same time that the role of the state in enforcing contracts became increasingly important. Both private and public sector institutions thus permitted the emergence of the complex impersonal forms of exchange that were essential to capture the economic benefits of modern technology, in contrast to the personalistic, discretionary style of resource allocation that has continued to characterize less dynamic economies.[6]

A number of studies have examined problems related to the legal, regulatory, and judicial environment in Africa and elsewhere.[7] Although these studies have quite effectively discussed these problems and how they are likely to inhibit private sector initiative, there has been no effort to quantify the harm done or to estimate the cost that it, or its avoidance, entails. As a result, there is little guidance as to the priorities for reform.

This study has developed and tested a methodology to identify and measure the importance of the institutional constraints that are inhibiting the growth of nontraditional exports. The focus is on this sector for several reasons. First, as argued above, it is key to economic growth in most African countries over at least the next two or three decades. Second, the development of nontraditional exports, frequently in cooperation with foreign partners, requires that close attention be paid to the transactions costs associated with property rights, technology transfer, contracts, financing, investment incentives, trade policy, foreign exchange policy, and a host of other areas that can frequently be ignored if production is destined for the domestic market or for traditional export markets. Thus the nontraditional export sector can be seen as key to opening countries up to flows of capital, technology, and institutional innovation, which have proved elsewhere to be vital for economic development.

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[6]See Douglass C. North, "Institutions," *Journal of Economic Perspectives*, 5(1), Winter 1991.

[7]Samuel Paul, "Assessment of the Private Sector: a Case Study and its Methodological Implications," World Bank Discussion Paper No. 93, Washington:1990; Louis Aucoin, "Current Status of the Legal System and the Rule of Law in Chad and its Effect on the Private Sector," Country Report No. 10, Center for Institutional Reform and the Informal Sector, October 1992; Clive S. Gray, "Reform of the Legal, Regulatory and Judicial Environment -- What Importance for Development Strategy," CAER Discussion Paper No. 10, Harvard Institute for International Development, August 1991.

B. Methodological Approach

The methodological approach used here is an extension of that used in the past to estimate comparative cost and incentive indicators for a number of African countries.[8] The methodology emphasizes the calculation of domestic resource costs (DRC) as an indicator of comparative costs and of nominal and effective rates of protection/subsidy (NRP and ERP/ERS) as measures of incentives. These indicators have served in many countries as an important input into decisions related to programs of structural adjustment and policy reform.

The domestic resources cost (DRC) for a particular productive activity is equal to the ratio of the value of domestic resources used in production, measured at their economic opportunity cost, to the value added that is created by these resources, measured in world prices. If this ratio is less than one, then more value is created than is used up in production, and the country has a comparative advantage in this activity; if the ratio is greater than one, the country has a comparative disadvantage. The nominal rate of protection (NRP) is the ratio of the domestic price of a product to its world price, converted to its import tariff or export tax rate equivalent by subtracting one. The effective rate of protection (ERP) is similar to the NRP, except that the ratio of domestic to world prices is replaced by the ratio of value-added in domestic prices to value-added in world prices, where these prices apply to both outputs and tradable inputs. Both nominal and effective rates of protection can be either positive or negative. The effective rate of subsidy corrects the EPC for taxes and subsidies on nontradable inputs.

The extension of this methodology involves estimating the costs of various institutional constraints. These costs are categorized according to whether or not they may be interpreted as an implicit tax or subsidy on tradable or nontradable goods and services, or, alternatively, whether they are part of the real economic cost of doing business. As an example, long delays in clearing exports or imported inputs through customs have costs that can be measured in terms of unnecessary fees, implicit interest charges, and wasted administrative effort. This acts effectively as a nontariff barrier, which can be converted to its equivalent tax on exports or tariff on tradable inputs. Similarly, firms that are unable to obtain financing through the formal banking system may have to borrow from the informal sector at much higher rates of interest. If the reason why bank credit is unavailable is that the government is crowding out the private sector in its demand for credit, then the higher interest charges may be considered as a tax on nontradable capital due to government policy. On the other hand, if the firm is unable to borrow because it is considered a bad credit risk, given the poorly developed capital market, then the additional charge should be considered as a real cost of doing business.

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[8]For an extensive discussion of the EP/DRC methodology, see J. Dirck Stryker, B. Lynn Salinger, Jeffrey C Metzel, and Elaine Tinsley, *Comparative Costs and Incentives Analysis: A Methodological Handbook*, Associates for International Resources and Development, April 1993. The agricultural sector in Madagascar is analyzed using this methodology in J. Dirck Stryker, Jeffrey C. Metzel, and Ashley S. Timmer, *Regional Specialization and Agricultural Growth in Madagascar*, report prepared for the UNDP and the World Bank, Strengthening of Planning Capacity and Economic Management Project, by Associates for International Resources and Development, December 1992.

The distinction between the costs associated with discretionary policies and those that are related to the level of market development is somewhat arbitrary but nevertheless critical. The former may be seen as influencing private profitability, but not economic costs, whereas the latter are part of the total costs that must be considered in deciding whether exports are profitable. As another example, one important factor in East Asia's success in expanding nontraditional exports has been a policy environment that permitted duty-free admission of imported inputs used in the production of exports. Yet, as this study has shown, it has been difficult to establish such a system in Africa that is free from cumbersome, arbitrary, and often discretionary procedures. Despite these problems, however, we believe that an efficient and transparent system of duty relief can be put in place in Africa, and we therefore treat the absence of such a system as a policy constraint capable of being overcome.

Although it has been tempting at times to compare Africa with Asia as a baseline in determining whether a particular institutional constraint should be treated as a disincentive or as a real cost of doing business, we have resisted this impulse and have instead tried to use either best practice in Africa or, as in the previous example, that which appears feasible with a reasonable amount of sustained effort. In this respect, we have tended to use experience with horticultural exports from Kenya and manufactured exports from Mauritius as a baseline, even if this seems to be just out of reach of most African countries. But as one managing director from Mauritius of a garment firm in Madagascar put it, "All the problems that currently exist in Madagascar also existed in Mauritius twenty years ago. You just have to keep chipping away at them."

Institutional costs in the calculations include both direct costs (e.g., unnecessary fees) and imputed costs (e.g., administrative effort to satisfy requirements, opportunity cost of tied up capital, losses associated with inability to convert foreign exchange at the best rate of exchange). In principle, they could also include the cost of having to go to the informal sector (e.g., higher cost of capital, limitations on economies of scale, lower quality of labor) and the risk associated with discretionary government intervention, illegal activities, and other sources of uncertainty. In practice, however, it has not yet been possible to measure these. Once institutional costs are estimated and categorized, a revised set of comparative cost and incentive indicators is estimated, inclusive of institutional costs and incentives.

A number of additional steps were originally envisioned in the methodology but were not attempted because of data limitations and because of the desire to limit the results, for the moment, to those that could be most solidly substantiated. For example, to estimate the overall magnitude of costs resulting from each institutional constraint, a calculation could be made of the difference between the level of exports that actually exists and that which could be achieved if this constraint was eliminated. Assuming that world demand is not the primary constraint on exports, this implies arriving at some estimate of the supply function for each product. Once the export gap is calculated for each product, the results could be aggregated and the total loss of exports, and even of GDP, could be estimated for each constraint.[9] The constraints could then

[9]It is important to recognize that once allowance is made for the reallocation of resources resulting from the elimination of one or more institutional constraints, the partial equilibrium model implicitly assumed here becomes less appropriate because of the general equilibrium effects that take place. This is a common problem

be ranked according to their contribution to the loss of exports and of GDP. Finally, some attempt could be made to estimate the costs associated with reducing or eliminating the most important institutional constraints, even if this could only be done qualitatively. These additional steps are discussed later in the section on recommendations for future research.

for any policy analysis, however, and is in no way unique to the estimation of aggregate losses associated with institutional constraints.

III. GHANA CASE STUDY

A. Introduction

Ghana was chosen as one of the case study countries for a number of reasons. First, it has already undertaken major economic policy reforms that have been critical to the expansion of nontraditional exports. Among these reforms have been devaluation and movement to a freely floating exchange rate, the elimination of taxes on nontraditional exports, the elimination of import controls, a sharp reduction in controls on foreign exchange, and a reduction and simplification of import tariffs. In addition, the government has provided additional export incentives through temporary admission, duty drawback, and bonded warehouse schemes for the duty and tax-free importation of inputs used in the production of exports, through exemption from sales and excise taxes on exports, and through an income tax rebate for exporters.

Second, Ghana has a number of the pre-conditions for successful nontraditional export growth. Agro-ecological conditions give it a comparative advantage in the production of horticultural and other agricultural crops. It has the marine resources that enable it to export products from the sea. Its timber resources give it a comparative advantage in wood processing. And it has a cultural tradition suitable for the production and export of Afrocentric products. Finally, despite a history of economic mismanagement, Ghana has a reasonably high level of education by African standards, and it has an entrepreneurial class with a long history of investment in new undertakings.

Third, Ghana is an interesting case study because it still has sufficient land and other natural resources, as well as a rich cultural heritage, that enable it to continue, for a time, to exploit its natural comparative advantage based on these resources before it has to move on to the labor-intensive production of standardized manufactured goods for export. In this sense, horticultural, marine, wood, and Afrocentric products can serve as a natural bridge to nontraditional manufactured exports, for which there are fewer cost advantages other than those involving labor. Thus, during this grace period, exporters can learn the importance for exports of market information, quality control, timeliness, and a host of other non-cost factors that are vital to competing in today's world market. At the same time, however, Ghana is also beginning to export standardized manufactured goods, so it is important to discover whatever lessons can be learned from this experience.

Ghana has already demonstrated its potential for rapid growth of nontraditional exports. These increased from $24 million in 1986 to $63 million in 1991. As a share of total exports, nontraditional exports rose from 3.2% in 1986 to 7% in 1990.[10] Thereafter, the rate of growth of nontraditional exports appears to have declined, but further analysis suggests some important trends lying behind the aggregate figures.

Table III-1 presents a breakdown by product group of nontraditional exports from 1986 to 1993. The most rapid and consistent growth has been in furniture and wood products and in

[10]Ghana Export Promotion Council.

TABLE III-1
MAJOR NON-TRADITIONAL EXPORTS
(million US $)

	1986	1987	1988	1989	1990	1991	1992	1993
Agriculture								
Horticulture	0.5	1.0	1.6	2.5	5.0	8.4	6.8	7.7
Fish	14.6	14.7	21.1	13.2	21.6	20.9	11.1	14.8
Other	2.6	3.1	4.5	5.4	2.3	4.6	4.2	3.6
(Cocoa Wastes)(2.1)	(2.4)	(2.9)	(2.2)	-	(1.8)	(0.7)	(0.0)	
Processed & Semi-processed								
Wood	1.5	2.1	3.3	3.8	5.5	6.2	15.5	18.8
Aluminum	0.1	0.7	6.1	2.5	9.8	9.8	4.9	3.6
Canned Foods	2.0	1.6	0.5	0.1	0.1	-	1.5	1.7
Salt	0.8	1.9	2.5	3.1	7.0	3.9	3.8	3.0
Other	1.5	2.7	2.8	3.8	10.6	7.8	19.2	15.9
Handicrafts	0	0.1	0.1	0.2	0.6	0.9	1.5	2.6

Source: Ghana Export Promotion Council

handicrafts. Horticultural products, while declining somewhat in value after 1991, have continued a strong upward with respect to tonnage, the value of exports having decreased only because of a slump in prices on the European market associated with recession. Within these product groups, it is possible to detect some strong trends. Among horticultural exports, for example, pineapple, yams/cocoyams, and fresh vegetables have done very well. Rubber and palm oil exports have also done quite well, though exports of rubber fell off somewhat in 1993. Within the wood products industry, most of the expansion is of builders' wood and furniture and furniture parts. In the other processed and semi-processed category, exports of garments and fashion accessories have grown rapidly, as have those of kente products in the handicrafts category.

Table III-2 provides data on the destination of Ghana's nontraditional exports from 1986 to 1993. Europe has been the most important market and has been growing in importance, while the market in the United States declined rapidly for awhile but now shows signs of increasing in importance. The West African market has also been growing strongly, especially the CFA countries, until 1993 when this trend was reversed for most countries except Nigeria. About one half of this trade is salt, a product in which Ghana has a strong comparative advantage, but much of the rest consists of products in which Ghana probably does not have a strong advantage. An important question is the extent to which this growth in trade has been due to overvaluation

TABLE III-2
DESTINATION OF GHANA'S NONTRADITIONAL EXPORTS

Destination	1986	1987	1988	1989	1990	1991	1992	1993
European Union	7.4	11.2	12.4	16.9	23.0	30.1	33.7	37.9
(United Kingdom)	(1.7)	(3.0)	(5.0)	(5.8)	(7.1)	(7.8)	(6.9)	(8.3)
Other Industrial	13.8	12.3	9.3	8.4	4.4	8.3	8.0	11.8
(United States)	(13.8)	(11.9)	(8.7)	(7.2)	(2.8)	(4.9)	(4.2)	(7.3)
ECOWAS	1.6	3.7	7.4	5.2	13.3	13.0	19.3	14.6
(CFA countries)	(1.1)	(2.9)	(6.3)	(4.3)	(12.1)	(11.9)	(13.6)	(8.0)
(Nigeria)	(0.5)	(0.8)	(1.1)	(0.9)	(1.2)	(1.1)	(5.6)	(6.1)
Other Africa	0.0	0.0	0.2	0.2	0.4	0.6	0.7	1.0
Other	0.1	0.7	13.0	4.0	21.2	9.8	6.7	6.5
(Cuba)	-	-	(1.0)	(0.6)	(9.4)	(3.3)	(1.8)	-
(Puerto Rico)	-	-	(5.8)	-	(8.0)	(4.3)	(2.1)	(1.9)
(Las Palma)	-	-	(5.5)	(3.1)	(3.2)	(1.9)	(0.8)	(0.0)
Total	23.8	28.0	42.3	34.7	62.3	62.6	68.4	71.7

Source: Ghana Export Promotion Council

of the CFA franc and will decrease now that the franc has been devalued. Finally, there was also, for awhile, substantial growth of nontraditional exports to other tropical countries, such as Cuba, Puerto Rico, and Las Palmas. Most of the exports to Puerto Rico were of bulk processed tuna, which is now being canned in Ghana. Exports to Cuba comprised largely aluminum products, which have since been eliminated, as have the frozen fish exports to Las Palmas.

The number of exporters in Ghana has grown very rapidly. In 1992, 3188 exporters exported 164 products, compared with 2822 exporters in 1991, 1729 exporters in 1990, and 1381 exporters in 1989. In 1992, there were 1323 exporters of agricultural products, 1658 exporters of semi-processed and processed products, and 207 exporters of handicrafts. Fewer than 350 of all exporters had sales in excess of $10,000. The 70 or so exporters that shipped goods worth $100,000 or more accounted for 92% of the total value of nontraditional exports.[11] In most product-categories, a few exporters dominate and the rest make relatively small shipments. This has been recognized by the Ghana Export Promotion Council, which narrowed the definition of exporter in 1993 so that only 1980 exporters were recorded, shipping 185 items.

[11]U.S. Agency for International Development, Bureau for Private Enterprise, *Financing Non-Traditional Exporters in Ghana: Assessment of Needs and Recommendations for USAID Assistance*, Final Report, prepared by First Washington Associates, Ltd. for USAID/Ghana, March 1992, p.14, and data from the Ghana Export Promotion Council.

Although the record of nontraditional export growth has been strong, major questions exist as to its sustainability and the potential that it has for becoming the mainspring of economic growth. For the moment, the nontraditional export sector is very small in comparison with Ghana's traditional exports of cocoa, minerals, timber, and energy. Growth has been rapid, but from a small base. There are major problems of telecommunications, high freight rates, limited contact with overseas markets, poor timing and quality control, and other areas that link foreign markets with domestic production. There are also numerous constraints involving such areas as administrative procedures, foreign exchange regulations, tax and import duty exemptions, access to financing, contract enforcement, labor legislation, land use rights, and a myriad of other aspects of export trade.

The purpose of this case study is to identify and measure the cost of some of the more important of these institutional constraints. To do this, the relatively rich documentation on Ghana's nontraditional exports was consulted, and informal interviews were conducted with officials in the government, banking sector, professional associations, and private firms engaged in nontraditional exports. Their patience, good will, and keen insights into the problems of nontraditional export growth allowed us to draft a questionnaire, which was subsequently administered to a total of 44 firms by a team from Databank Ghana Limited. This questionnaire was in two parts. The first was essentially qualitative in nature and was designed to assist in identifying the most important constraints on the expansion of nontraditional exports; the second part, which was completed by about half of the firms, was quantitative and was used to estimate comparative cost and incentive indicators and to adjust them for the costs of institutional constraints. The questionnaire is presented in Annex C.

The next section of this chapter describes briefly some of the major features of the institutional environment within which nontraditional exports are expanding. It also identifies the major institutional problems. This is followed by a discussion of the survey and a statistical analysis of its results. Following this there is a discussion of the methodology and a presentation of the results of the DRC/institutional cost analysis. Thereafter, the report distills all of the analysis for its policy implications.

B. Institutional Environment

Much has already been written about the institutional environment surrounding nontraditional exports in Ghana. This analysis has been instrumental, in fact, in improving that environment. Here we try to summarize the most salient features of this environment and to identify where the principal barriers to growth remain. In organizing this section, it is helpful to use the conceptual framework of the legal, regulatory, and judicial (LRJ) environment, though we go beyond this to deal with a number of other areas in which the institutional structure is vital for export growth.

1. General Framework

Ghana is unlike many African countries in that it has a highly developed legal infrastructure with a large number of judges and domestically trained lawyers.[12] The origins of the legal system in Ghana go back to the beginnings of the colonial period, when received English common law was superimposed on local law. Although the supremacy of English law was negated by post-independence governments, the duality of the legal system has been upheld by each new constitution.[13]

After the Provisional National Defence Council (PNDC) came to power at the end of 1981, and prior to the approval of the new constitution in 1992, this two-tiered legal system remained in effect, but was subverted, in the event of conflict, by the "laws" of the PNDC. This undermined the confidence of the business community in its ability to seek judicial relief from government violation of property rights.[14] During the process of structural adjustment, which began in 1983,

> ...the PNDC chose administrative mechanisms rather than the rule of law to implement the international lenders' targets regarding trade, currency and price liberalization. In areas such as banking reform, foreign investment promotion, and initially in price and currency stabilization, the PNDC used administrative agencies to meet structural adjustment targets. The pattern over the ten years of structural adjustment has been to use State institutions rather than positive law to implement economic policy.[15]

Undoubtedly, this contributed to the short-term success of the structural adjustment program because it greatly simplified decision-making and made it easier to reduce the role of the public sector in favor of private enterprise. Furthermore, many of these decisions were politically legitimized when Jerry Rawlings was elected President in 1992 under a new constitution that restored at least some of the older legal structure. Nevertheless, and this is by no means unique to Ghana, it is quite evident that the legal system has not been at the center of economic reform.

This situation is exacerbated by the inability of the courts to cope with the volume of litigation. A Special Tribunal has been established as a means of resolving some of the litigation associated with banking reform, but this is only a short-term measure. Elsewhere, the tendency has been to create promotional and regulatory agencies, such as the Ghana Investment Center, which seek to replace the statutes and independent courts in protecting property rights through

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[12] Julien E. Naginski, "Economic Conditionality and Legal Unconditionality: Structural Adjustment in Ghana (1983-1992)," MALD Thesis, Fletcher School of Law and Diplomacy, Tufts University, February 5, 1994, p. 7.

[13] Ibid, p. 4.

[14] Ibid, pp. 5-10.

[15] Ibid, p. 17.

institutional, rather than legal, means.[16] Although this speeds up the approval process, it also inevitably introduces a large degree of discretionary authority, which creates uncertainties for potential investors. What is needed, instead, is the primacy of an independent judicial system that will resolve disputes, enforce judgments, and independently interpret and administer the law.

In the absence of such a judiciary, it is important to identify how these functions are fulfilled by other institutions and the constraints that this imposes on economic growth, in general, and on the expansion of nontraditional exports, in particular. To what extent, for example, are firms reluctant to invest because of the insecurity associated with inadequate safeguards over property rights? Do personal contacts and family or school ties take the place of more formal means of reducing risk and resolving disputes, and, if so, to what extent does this inhibit growth?

2. Trade Legislation

The principal legislation governing international trade in Ghana is the Imports and Exports Act of 1980. With the liberalization of the trade regime, however, this statute has been rendered obsolete.[17] The payment and drawback of customs and excise duties is governed by the Customs and Excise Decree of 1972 and the Customs Regulations of 1976. The legislation related to nontraditional exports is the Imports and Exports (Non-Traditional Exports) Regulations of 1987.

Nontraditional exports are subject to a zero rate of export duty and are exempt from the payment of sales and excise taxes. Inputs used in the production of exports, unless exempted from the payment of taxes (see below), are subject to an import duty of from 0 to 25%, if imported, plus a sales tax ranging from 0 to 35%.[18] Current plans call for the introduction of a value added tax in early 1995. Exports will be exempt from payment of this tax.

a. Export Procedures

The problems regarding export procedures are very well documented.[19] Many of these procedures have been simplified in recent years, partly as a result of the attention that has been

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[16]Ibid, p. 27.

[17]This statute is currently being redrafted by the Ministry of Trade and Tourism to bring it in line with current policy.

[18]The higher rates apply to luxury goods. In most instances, duty rates were not greater than 20% and sales tax rates did not exceed 17.5% in 1992, the year to which the survey applies. The 1994 Budget Statement revised the upper duty and sales tax rate figures to 25% and 35%, respectively.

[19]The most detailed explanation and evaluation of these procedures is contained in Industrial and Management Services Limited (IMAS), *Final Report on Bureaucratic Constraints within the Non-Traditional Export Sector in Ghana*, prepared for USAID/Ghana, June 25, 1992. Also useful in summarizing and explaining the procedures is Ghana Export Promotion Council, *Beginner's Guide to Exporting*, Accra: n.d.

paid to them. Here we are only concerned with outlining the procedures now in place and with drawing attention to some that we consider unnecessary or too expensive.

All commercial exporters that are registered as businesses with the Registrar-General's department are required to register with the Ghana Export Promotion Council (GEPC). The cost of doing this is C25,000 for the first year and C20,000 yearly thereafter. Many exporters do not consider that they receive any useful services in return, though some do appreciate the assistance given them by GEPC. The same cannot be said for required fees paid to the Ghana Shippers Council (C10,000 to C250,000 per year, depending on the volume of trade), for which virtually all exporters perceive no return.

In addition to these general organizations, most exporters also pay fees to industry specific professional associations. These fees vary from C10,000 to C50,000 and are generally more willingly paid because the associations are in closer touch with the firms' problems and can more effectively intercede on their behalf.

The major exception to this is the C30,000 annual fee required by the Forest Products Inspection Bureau (FPIB), which also requires exporters to travel to Takoradi with their products and pay 1% of the FOB value of exports in order for the Bureau to certify that the export contract is in order and that no rare species are being exported. Furthermore, the FPIB will not approve export contracts unless the prices reached are within price guidelines received from their agents in London. Port permits from FPIB are also needed before exports of wood products are permitted. All of this is perceived as being extremely onerous. It is difficult to justify these requirements, given the limited volume of wood contained in furniture and other wood products in relation to value added and the high cost of compliance in relation to any conceivable national benefit.

Another unnecessary authorization that was required until recently for each item shipped was certification by the Museum and Monuments Board that no national treasures were being exported in the form of handicrafts. The cost of this certification was C500 per item, which was very expensive when the item was of relatively low value. Although this requirement has now formally been eliminated, it is important to assure that it is no longer applied in practice.

In addition to these industry specific approvals, each shipment must have an Income Tax Certificate showing that all income taxes have been paid (C500). While useful in helping to enforce the assessment of income taxes, this has nothing to do with exports and must be considered as a barrier to trade. Ghana Standards Board approval (C5,000) is optional, but a Chamber of Commerce Certificate of Origin (C5,000) must be obtained for each export shipment. While the latter might be required by the importing country, the question arises as to whether obtaining this certificate should not be optional for the exporter. Given the importance of preferential trading areas in Africa and overseas, however, it is can be argued that this requirement is justified since a certificate of origin is required nearly everywhere and the potential cost to the exporter of not having the certificate when needed is far higher than the cost of obtaining it in the few cases where it might not be needed. For this reason, the requirement to obtain a certificate of origin is not treated here as an unnecessary institutional cost.

As goods are being prepared for export, the exporter must obtain from his or her bank the Exchange Control Form A2, which must be completed and returned to the bank with a commercial invoice and all the export approvals and permits described above. To a large extent, this is a holdover from the time when rigid exchange controls were in effect. Banks typically charge 1% to 1.25% of the FOB value of the shipment for processing these forms and handling the foreign exchange transactions, of which 0.5% goes to the Bank of Ghana. More important, the commercial banks use this form to bind their customers to them when the former convert their foreign exchange earnings into local currency, thus allowing the banks to exercise some degree of monopoly power over the exchange rate at which this transaction takes place. Most of the information obtained on the Form A2 is also contained on the Customs Entry Form, so there appears to be considerable redundancy and unnecessary expense involved. Since the Customs Entry Form is internationally standardized, if the Bank of Ghana still wants supplementary information, it could continue to use the Form A2, but this form should not have to approved by the commercial banks and the exporters should not be charged for processing the form. As it stands, the fees charged and the requirement that the Form A2 be approved by a commercial bank amount to an implicit tax on exports.

Once goods are taken to the port or the airport, the exporter is required to present a Customs Export Declaration Form and to have it processed by the Customs, Excise and Prevention Service (CEPS) and the Ministry of Trade office. The form costs C5,000. It is customary at this point to give tips in order to expedite the process. If a forwarder carries out these operations for the exporter, he normally charges for these tips under the category "sundries". The cost can vary from C500 for a small package up to C50,000 for a 20' container. While not strictly legitimate, these tips are widely recognized and accepted.

Agricultural goods must, at this point, obtain a Plant Protection and Quarantine Certificate from the Ministry of Agriculture, and fish and fish preparations must obtain a similar certificate from the Fisheries Department of the Ministry of Agriculture. The cost is C500. These shipments are also required to obtain a Port Health Certificate at a cost of C1000. These are standard procedures anywhere in the world.

b. Procedures for Imported Inputs

Given the fact that exporters must compete actively on world markets with producers from other countries, it is imperative that their costs be kept to a minimum. This implies that they need to be able to use intermediate inputs that are not taxed and, if imported, come into the country with a minimum of expense and delay. Yet the impression gained from talking with exporters is that the procedures for granting them tax exemptions or duty drawbacks do not work effectively and that the procedures for clearing imported inputs are more cumbersome and the delays are longer than for exports.

i. Duty-Free Admission of Imported Inputs

The basic legislation for the duty-free admission of imported inputs is the Customs and Excise Decree of 1972 (NCRD 114), as supplemented by the Customs Regulations of 1976. These provide for duty drawback, duty exemption, duty suspension, and bonded warehouses.[20]

Duty Drawback. The rebate of import duties and of sales and excise taxes paid on imported inputs applies to goods exported either in the same condition or after some process of manufacture. It operates on a case by case basis requiring firms to submit applications based on detailed, auditable evidence that duty and taxes were actually paid, inputs were actually used, and exports actually took place. This system is inherently complicated because of the paperwork and signatures required. In addition, applications take several months to process, so that the value of the drawback is eroded by inflation, financial charges, and administrative costs. Many applications are denied on technicalities. As a result, very little use is made of this scheme.

The drawback system used in Ghana only takes applications from exporters who have directly imported the dutiable inputs. This induces vertical integration and denies duty-free rights to domestic suppliers of the inputs used in exported goods, thereby penalizing them viz-a-viz imports of the inputs, unless it can be clearly shown that the locally furnished inputs could only have been used in the production of exports. Because the record-keeping required to extend duty-free status to domestic suppliers is cumbersome and may involve the sharing of information considered proprietary, some countries get around this problem by allowing duty relief to be calculated on the basis of sets of input-output coefficients.

Duty Exemption. Importers can obtain duty exemption through the GIC or by certification from another government agency. There is no general exemption for intermediate products that are used in the production of exports, but the Revenue Secretariat can grant exemption on a case by case basis. Similarly, sales and excise taxes can be deferred until after production, at which time the final products are exempted if exported. Clearly this system is fraught with discretionary decisions that are subject to abuse.

Duty Suspension. Suspension or conditional exemption from duty can be granted by the Commissioner of Customs if the imports are intended for re-export in the same condition within three months and a bond is posted for the dutiable amount. Suspension is rarely granted and, in any event, is not applicable to intermediate products used in the production of exports.

Bonded Warehouses. The customs code allows for the establishment of warehouses to hold imported goods temporarily without payment of duty, which is postponed until the importer is ready to take possession of the goods. If the goods are re-exported in the same condition, no duty is paid. Where the entire production unit can be treated as a bonded warehouse, no duty is paid if the goods are used in the manufacture of products that are exported. This system appears

[20]Much of the material in this section is taken from Norberto A. Quezada, "Ghana: Duty Relief Instruments for Non-Traditional Export Promotion," Sigma One Corporation, June 10, 1992.

to be increasingly used in Ghana, but, because of the need for monitoring by the customs service, it is limited to medium and large firms.

ii. Import Procedures

The procedures involved in importing intermediate inputs are similar to those required for exports. The importer must have the proper documentation, including bill of lading, packing list, invoice from the supplier, clearance from SGS certifying that the invoice amount is correct, Income Tax Certificate, Customs Bill of Entry Form, Ghana Shippers Council Certificate, and health and fumigation certificates if the imports are food items. He or she must also prepare an Import Declaration Form, which is submitted to a bank in order to transfer cedis into foreign currency. Forwarding agents estimate that the time for clearance averages two weeks, but it can take up to several months. They also say that it could be accomplished in 3 to 5 days.

3. Investment Incentives

Foreign and domestic investment outside the petroleum and mining sectors is governed by the Investment Code, 1985 (PNDC Law 116); the Investment Code (Areas of Special Priority) Instrument, 1991; the Investment Code (Amendment) Law, 1992; the Investment Code (Immigrant Quota) Regulations, 1992; and the Technology Transfer Regulations, 1992. This legislation has been a very important part of the institutional environment influencing business decisions. It establishes the Ghana Investments Centre (GIC) as the one stop agency of the government responsible for the encouragement, promotion, and co-ordination of all investments in the Ghanaian economy with the exception of the mining, minerals, and petroleum sectors. The duties of the GIC include

1. collection, analysis, and dissemination of information about investment opportunities and sources of investment capital, as well as assistance in finding partners for joint ventures;

2. identification of specific projects and invitation to potential investors for implementation;

3. organization of promotional activities;

4. approval of the establishment of enterprises under the Code;

5. approvals qualifying investors for benefits under the Code;

6. securing of all licenses, approvals, permits, etc. required to enable any approval granted by the Centre to have full effect;

7. liaison between investors and ministries, public agencies, institutional lenders, etc.;

8. monitoring and enforcement of compliance with terms and conditions of approvals granted under the Code;

9. approval of technology transfer agreements relating to investments under the Code;

10. recommendation of changes in legislation and simplification of procedures.

The Code also defines certain priority areas for investment, as well as the incentives and benefits under each category. The priority areas were originally designated as agriculture, manufacturing, construction, and tourism. These priority areas were detailed much more specifically and expanded to include the service sector in 1991. Benefits include exemption of customs duties for the importation of plant and equipment, investment and depreciation allowances for income tax purposes, and income tax rebates and exemptions. Other tax reductions or deferments are authorized if companies locate in certain regions, invest in infrastructure, or use Ghanaian labor in preference to imported machinery. The legislation also allows the retention of at least 25% of foreign exchange earnings in an external account and free transfer of dividends, profits, loan service payments, technology transfer fees, and capital proceeds upon liquidation or sale. There is also a guarantee against expropriation.

As subsequently amended in 1992, the Code calls for a minimum foreign investment of $10,000 for a joint venture and $200,000 for a wholly foreign-owned enterprise (also required to be a net earner of foreign exchange). This minimum capital requirement is suspended for export trading enterprises. A separate section originally listed twenty types of enterprises wholly reserved for Ghanaians, but this was amended in 1992 to limit the list to four types. Legislation in 1992 also specifies immigration quotas of two to four persons, depending on the amount of investment, for firms under the Code.

In practice, the GIC has become more of a regulatory agency than one responsible for promotion. The complexity of the Code and related legislation has resulted in a highly discretionary approval process, in which projects are evaluated with respect not only to their priority for the government but also their viability. Despite the supposed one stop role of the GIC, approvals in fact have to be obtained from numerous individual ministries, and this can take months.

As a result of these and other problems, the Code is being revised to decrease GIC's regulatory and approval power and to increase its promotional role. There is to be less discretionary authority and less dependence on approval advice from individual ministries. Sector priority and project viability are not supposed to be a concern as long as clearly stated requirements are met. Minimum capital requirements are to be lowered to $10,000 for a joint venture and $50,000 for a wholly foreign-owned enterprise because of the inability of many Ghanaians to raise much capital. Procedures are to be simplified. Less stress is to be laid on production for the domestic market and more on exports. Requirements regarding technology transfer are to be reduced to registration with GIC as long as basic guidelines are met.

The revised code is yet to be approved by Parliament. It remains to be seen how this new orientation will work out both legally and in practice. Some of the need for regulation has been reduced by economic reform. For example, GIC previously tried to regulate the payment of fees for the use of technology since this was an important way of getting foreign exchange out of Ghana. This is no longer as profitable now that there is little differential between the rate of exchange offered by banks and that of the free market (foreign exchange bureaus, overseas transactions, etc.). Another question relates to the applicability of Code benefits to wholly Ghanaian-owned firms. In principle they are available, but in practice they have not been, at least until recently. This raises the issue of whether it would not be better to eliminate the special Code status altogether and to incorporate most of its benefits into legislation applicable to all firms.

4. Land Legislation

In 1986, the Government of Ghana enacted the Land Title Registration Law, which deals with the concerns of private and/or legal persons who seek to acquire land in Ghana aimed at promoting business activities in the traditional and nontraditional export sector. Previously, the principal legislation governing the registration of instruments affecting land was the Land Registry Act 122, which was inherited from the 1960s and suffered from a diverse set of problems, ranging from uncertainty of title for acquisition of land and lack of precision in registration procedures to the absence of rules governing arbitration in cases involving land disputes.

The new legislation introduced the system of mandatory land title registration to guarantee transparency, speed, and timely handling of matters concerning land acquisition in Ghana. This new system of land title registration is aimed at facilitating proof, rendering dealings in land safe and simple, and preventing fraud on purchasers and mortgagors. All private individuals or enterprises who engage in the promotion of traditional or nontraditional exports have welcomed the new legislation since it provides a warranty of title for all persons registered as owners and acts as a bar to adverse claims.

Most land in Ghana has historically been held under fiduciary rights by users. Chiefs customarily have provided lease-hold documents with terms and conditions signed by both parties. But investors have faced several problems under this system of land acquisition. One has been lack of clarity regarding boundaries, which are often subject of litigation and adjudication in regular courts. After the death of a Chief of a jurisdiction, there has often been uncertainty about the continuance of the agreement. Frequently, the new Chief has disclaimed knowledge of the previous transaction. As a result, investors have lost time and incurred additional expenses for a renewal of their title. Commonly, there has been insecurity and overlap of entitlement since another individual may have claimed title to the same land after having been granted title by another Chief or elder earlier. The existence of such competing interests often has resulted in redundant and unprofitable litigation, inhibiting commercial and agricultural development of land.

The new Land Title Registration Act deals with this problem of land transactions between the Chief of a jurisdiction and another natural or legal person. It introduces various safeguards

for all parties involved. Part I, Section I provides for the establishment of a Land Title Registry. Documents are sent to the Land Commission in the region for approval and validation of the agreement. The Land Commission examines the documents to check compliance with various regulations. It makes sure that there is no conflict with other transactions. Nevertheless, it is the task of the investor to conduct an early search to prevent overlap with other investors claiming entitlement to the same land. The Land Commission makes sure that plans are adequately drawn and conform with the required specifications, including compliance with environmental standards. The property, for example, must not suffer chemical spill-overs from the business activity and there must not be any other sort of structural damage.

In addition, since the Chief is generally not the sole beneficiary, the Lands Commission has been given additional power of oversight. It can advise the investor or lease holder, for example, as to how to get out of an old lease that is no longer applicable to the current situation. It has also the right to propose amendment of lease payments if they are not reasonable. In this respect, its main goal is to look after the interests of affected parties, including the traditional and district councils, who are not directly involved in the negotiations and are not legally protected, but are affected by the agreement.

Subsection 2 of Section 1 provides for the maintenance of land register and other records that would facilitate efficient management of the Registry Offices. For this purpose, a Chief Land Registrar is appointed, who is empowered to appoint other Land Registrars and Assistant Land Registrars to the various Registry Offices. To alleviate the problems of competing claims arising under the old system, Section 18(1) provides for the conclusiveness of land register as evidence of title. Section 19 provides a list of persons who may be registered as proprietors, as a result clarifying uncertainties as to who has a registrable interest in land. Of the interests listed in Section 19(1)a-e, the best is the allodial title, which is the full title to land. There is no superior title beyond that, and in some traditional areas in Ghana, the allodial title is vested or held in the areas of stool of skin. The community in which the allodial title is vested has complete and absolute freedom to dispose of it.

However, conditions of title registration are very onerous because one has to know the history of the land very well and have very detailed surveys. Ghana has still a long way to go, considering that the land registration system in the UK is 50 years old and not even all land is under title to date there. Instead, most land is registered by deed, which is almost equivalent to title registration but is considerably simpler.

Overall, the goal of the new system is to provide for transparency and timeliness in procedures. If the documents are well drawn, procedures can be completed in about 10 days. But often documents are faulty and since the Commission does not have the right to correct them, they must be returned to the submitter. Thus the process takes longer. It can, however, be expedited for a fee of 10,000 cedis. Search costs in any case are C2500/acre.

5. Labor Regulation

The Industrial Relations Act of 1965 and the Labor Decree of 1967 are the two governing laws concerning labor in Ghana and they apply to all establishments irrespective of their nature.

Investors (foreign and domestic) must go through the Ministry of Labor for recruitment of labor (skilled and unskilled). This has been expressed as one of the major areas of concern for potential foreign investors. In the practical application of these regulations, they are seen as quite cumbersome, costly, and time consuming. It makes the hiring process lengthy and uncertain. The Ministry of Mobilization and Productivity is also supposed to monitor the firms' compliance with the labor laws, but in practice well connected investors circumvent this barrier effectively.[21]

Minimum wage is regulated by the Tripartite Committee on Wages and Salaries, which consists of representatives of the government, employers, and trade unions. At the company level, employers negotiate wages with employees with the exception of manufacturing industry, where the Industrial and Commercial Workers' Union of TUC (Ghana) assumes the responsibility of negotiating wages with employers. According to law, enterprises can be closed and workers retrenched; however, the retrenchment process must be initiated with an advance notice of about two months and consultations with unions representing the company's employees are required. The terms of retrenchment are negotiated by the management with the Committee for the Defence of the Revolution, though this is not legally required. In reality, however, retrenchments are conditional on the approval of powerful political groups such as the Committee.

Overall, the operation of the labor market seems to be driven by a multiplicity of formal and informal regulatory barriers. For example, for the laying off of workers, the political and financial aspects are so significant that the release of inefficient workers becomes very difficult. Although laying off of workers is an unpopular decision for all parties involved, it is a crucial factor that must be considered from the firms' point of view. Lack of flexibility in this respect is likely to discourage employment at the margin, and weigh heavily in investors' decisions.

6. Financial Markets

In Ghana, nontraditional exporters can finance their exports through various ways. There are public and private commercial banks, three merchant banks, and one government backed export finance institution -- the Export Finance Company (EFC) -- that offer financial services to exporters. Since the initiation of the Financial Sector Adjustment program in 1988, the financial sector in Ghana has experienced major changes. Particularly, commercial banks have seen their organizational structure, management, and operating procedures altered. Simultaneously, they have revised their lending policies and practices to the export sector.

Credits by commercial banks to nontraditional export trade have decreased in relative terms substantially, reaching only 4.4% of total bank credit in 1990, after attaining 5.1% in 1987.[22] In Ghana, as in many other developing countries financial institutions are

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[21] Samuel Paul, *Assessment of the Private Sector, A Case Study and Its Methodological Implications*, World Bank Discussion Papers 93, 1990, p. 29.

[22] USAID, *Financing Nontraditional Exporters...*, p.22. This figure excludes lending to cocoa, timber marketing and minerals, but includes credit for diamonds and gold.

conservative, risk averse, and prefer to lend mainly shorter term credits at high rates of interest. They offer small amounts of credit to exporters and require more collateral than in industrial countries. In addition, they are less experienced and well-connected internationally and, as a result, are less willing to make export loans. Finally, they are discouraged from making loans by the alternative of investing in Government and Bank of Ghana bills and bonds, which until recently paid rates of interest up to 35%.

Credit is important to nontraditional exporters at all stages, beginning with the need to finance pre-shipment needs for working capital to purchase inputs and to manufacture and pack goods for export. Credit is also important at the post-shipment stage to bridge the gap between the shipment of goods and the receipt of payment from the overseas purchasers. Ghana's nontraditional exports are sold on very short terms, however, and they require little post-shipment finance except for periods of 30 to 60 days for goods on consignment (horticulture), some sales on a documentary collection basis of 90 days or less, and some sales within the region.[23]

Nontraditional exporters have access to pre-shipment or post-shipment financing from commercial banks upon provision of confirmed, irrevocable letters of credit (LC) or export documentary collections as verifiable evidence for their export transactions. The advantage of LCs is that the commercial banks know before shipment the terms and conditions under which the exporter will be paid. In case of export documentary collections, on the other hand, the banks only know after shipment the terms under which the seller anticipates being paid. Nevertheless, commercial banks in Ghana do advance funds against export documentary collections as well as LCs. All commercial banks provide pre- and post-shipment working capital loans under lines of credit established on an annual basis. Project financing for nontraditional exports is also provided on a case-by-case basis. Most recently, banks have developed bankers' acceptances, which are held in portfolio and can be rediscounted at the newly formed discount houses.[24]

Despite these avenues, nontraditional exporters have expressed their dissatisfaction with the availability of capital. Access to working capital is difficult because many banks require 100 percent collateral or, more specifically, liquid collateral (cash, certificates of deposit, or marketable securities) or real estate. Inventories are seldom used as collateral because of problems of guaranteeing their security. Even real estate offers poor collateral because of difficulties of foreclosure through the legal system.

Another constraint is the perceived high cost of export financing. Until recently, interest rates were kept at higher levels in Ghana than on the international market because of high rates of domestic inflation. Although many exporters complained that they were therefore less competitive compared with foreign suppliers, this ignored the very substantial gains that they made as a result of the depreciation of the cedi. Nevertheless, only a small percentage of

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[23]Ibid, p.83.

[24]Ibid, p. 31.

exporters use the commercial banking system to finance their exports. Furthermore, many nontraditional exporters do not qualify for loans from the banking sector because they lack banking experience and have poor collateral.

Nontraditional exporters can also receive financial services from merchant banks. These banks have not had to be restructured and, due to their conservative lending policies and their young age, they are less troubled than commercial banks. Merchant banks cover all the services provided by commercial banks in addition to managing money and being active in the capital market. For example, they advise and confirm letters of credit, provide pre and post-shipment loans to exporters, participate in foreign exchange transactions, and provide foreign exchange services. Merchant banks see themselves in a better position to provide such services than commercial banks. Furthermore, exporters have easier access to financing at merchant banks due to their more flexible collateral regulations. However, small exporters face similar problems with merchant banks as with commercial banks.

In order to remedy the problem of access by small exporters to trade finance, the Export Finance Company (EFC) was created to provide assistance to smaller nontraditional exporters in acquiring short-term loans from commercial or merchant banks. Instead, however, the EFC provided direct loans to exporters of 90-180 days for specific transactions evidenced by confirmed export orders or letters of credit. Furthermore, the EFC financed up to 100 percent of the costs of producing the export order, including purchase of raw materials, processing, transport, etc. Overall, the EFC supported a larger number of exporters compared to the merchant banks and commercial banks. Unfortunately, the EFC has also had considerable difficulty collecting its loans, and its financial viability remains in doubt.

Although there are some problems involving access to short-term capital, especially for smaller exporters, the most important financial constraint is the availability of capital for fixed investment. This is of little interest to the commercial banks, and even the merchant and investment banks, given the problems of the past and the availability of alternative financial instruments that they can hold and on which they receive a reasonable rate of return. There are several special programs, offered by the donors, to finance the purchase of plant and equipment in order to increase or upgrade production capacity. However, size and other program eligibility requirements limit the usefulness of these programs to meet widespread needs of exporters. Furthermore, some exporters have had bad experiences with these programs, largely because of the depreciating cedi and the terms upon which the loans had to be repaid.

Insurance companies in Ghana have also played a role in financing nontraditional exporters. The insurance companies, for example, are the primary owners of the EFC and they are also investors in merchant banks and the discount houses. They issue domestic credit insurance to facilitate domestic loans and the purchase of capital goods financed by loans from foreign credit agencies . Insurance for export credit risk has not yet been profitable, but the insurance industry remains interested in the nontraditional export sector because of the expectation of an increase in volume in profitable casualty business.

Several other recent initiatives are worthy of mention. The Export Finance Office being set up under the Private Enterprise and Export Development Project, financed by the World

Bank, will provide short-term guarantees, up to 65% of the face value of the loan, to banks for pre-shipment finance. There will also be a 100% rediscounting facility designed to facilitate the commercial banks' cash flow. The Eximguaranty Company has been established to provide credit guarantee cover to medium and small enterprises and to reduce the risks associated with trade finance, including post-shipment loans that cannot receive guarantees from the Export Finance Office. Credit guarantees can also be used for term loans up to a maximum of 15 years. Finally, the Ghana Leasing Company, which has been in business since 1992, assists companies interested in making fixed investments, though its operations are for the moment restricted to the larger, more successful firms.

In sum, financing remains an important factor for the promotion of nontraditional exports in Ghana, both for working capital and for plant and equipment. A few exporters operating in the formal sector possess the requisite financial and accounting knowledge to obtain financing for their activities to export internationally on a competitive basis. Most exporters, however, face various financial constraints, including high cost of capital, difficult collateral requirements, cumbersome procedures, and poor access to working capital and term finance. Those exporters operating in the informal sector, particularly, as well as those with rudimentary accounting and financial knowledge, as well as performance or loan repayment problems, have had difficulty obtaining funds from financial institutions.

7. Foreign Exchange

Following the introduction of the Economic Reform Program in 1983, foreign exchange management was progressively liberalized. As a result, access to and use of foreign exchange has few restrictions and the exchange rate of the cedis is now largely market determined. Interest and dividends are allowed to be remitted abroad and capital can be repatriated with no restriction, though Bank of Ghana approval is required. Ghanaian residents are allowed to maintain various types of foreign exchange accounts.

Foreign exchange retention and external accounts are the two important accounts relevant to enterprises. The foreign exchange retention account allows the exporters to hold a portion of their export earnings in foreign exchange in local banks. Prior to 1993, nontraditional exporters could deposit 35% of their export earnings directly in these accounts; the other 65% had to be converted to cedis at an exchange rate determined by the commercial bank, or in the case of some large transactions by the Bank of Ghana. The 65% requirement was eliminated in early 1993, though exporters still find it necessary to convert foreign exchange into cedis to pay their local bills. Furthermore, commercial banks that approve the Form A2 often require that the foreign exchange earned under this approval be converted through them into local currency, thus maintaining some monopoly power over the exchange rate at which this conversion takes place. This is a problem especially for smaller firms that do not have the bargaining power of the larger firms in their negotiations with the banks. Nevertheless, the inter-bank market for foreign exchange has become increasingly competitive, so that costs of this requirement have been considerably reduced.

Continuing liberalization of the financial sector requires frequent changes in procedures. As a result, there is widespread lack of information about the procedures governing foreign

exchange transactions. The latest regulations are not available to all parties; sometimes even the staff of the banks is not informed about changes in the regulations. Nevertheless, Ghana has made enormous progress in its foreign exchange management and it would benefit by making potential investors aware of the country's liberal foreign exchange regime.

8. Direct Taxation

The tax regime has a significant impact on the level and composition of investment. In Ghana, enterprises are taxed according to the Income Tax Decree of 1975 through a combination of taxes on profits, dividends, and capital gains. However, the 1985 Investment Code provides generous incentives in the form of capital allowances, tax rebates, tax holidays, and duty exemptions on equipment for a wide range of priority activities.[25] The Government's objective in this area is to balance the demands for a low marginal effective tax rate to encourage investment versus the need to generate revenue.

Chargeable income tax rates for enterprises in Ghana are high compared to rates in many other developing countries, even though they were reduced in 1991. The enterprise income tax is 45 percent for companies in construction and real state development; the rate is 50 percent for all other companies, including farming companies and companies in banking, insurance, commerce, and printing.[26] In many other countries, an income tax rate of 30-35 percent is the norm. Industries that are granted exemption under the Investment Code have to pay a minimum tax of 5 percent of turnover after the first five years irrespective of the actual profit of the business.[27]

Clauses 5(2) and 7(2) of the Tax Decree provide for capital allowances for enterprises which have received income tax benefits under the 1985 Investment Code in respect of buildings, plant, etc.[28] The capital allowance varies by activity and type of asset. For example, according to section 13(6) of the Tax Decree, capital allowances granted to manufacturing enterprises are 40 percent in the year of investment and 20 percent in subsequent years. Furthermore, interest cost of finance can be deducted. To encourage investment in selected sectors, the Tax Decree provides for tax holidays ranging from 3 to 10 years for agricultural activities and real estate, and a loss carryover for two years after the tax exempt period.[29] However, there is no carryover of

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[25]Ministry of Industry, Science and Technology, *Kind and Level of Protection Required by Ghanaian Industries*, Draft Final Report, Submitted by Plan Consult in association with Louis Berger International, Inc., p.45.

[26]Ibid, p. 48.

[27]Ibid, p. 46.

[28]Ibid, p. 47.

[29]Ibid, p. 46.

operating losses for manufacturing. A rebate on taxable income, ranging from 30 to 75 percent, is provided for companies exporting part of their output.[30]

There is a 30 percent final tax on dividends paid out by the company from its after tax income. The capital gains tax rates on the sale of assets, including business stocks and shares, are also high and vary with the length of the holding period (from 55 percent for assets held for less than 5 years to 15 percent for assets held over 20 years). Another disincentive is the use of historic cost as a basis for calculating depreciation, as stipulated by the tax code. If asset prices rise rapidly due to exchange rate adjustments, profits (and taxes) are inflated, and eventually firms will have difficulty replacing their assets. The lack of general carryover of operating losses deters investment particularly in ventures that expect returns in the longer term or face more than average risks. High capital gains taxes also deter firms from engaging in mergers and acquisitions that are urgently needed for the rationalization of the manufacturing sector and the divestiture of public enterprises. The high tax on capital gains and dividends also deters equity financing; at present, rewards of successful ventures are largely taxed away, and investors are likely to choose a safer outlet for their funds, such as tax exempt government bonds.

All domestic earnings of foreign companies and individuals are subject to the same taxes as for Ghanians except for the Selective Alien Employment Tax for each expatriate employed (500,000 cedis) unless exempted by the GIC. There is a minimum tax of 35 percent on total income of foreign businesses. Ghana has no active double taxation agreements with other investor countries currently.

C. Survey of Nontraditional Exporters

In order to better identify the institutional constraints facing nontraditional exporters and to learn something of their perspective on these constraints, a survey was conducted under sub-contract by Databank Ghana Limited during the period March-June 1993. The survey included 44 firms grouped into the following industries: horticulture (9); other agriculture (3); marine products (5); processed foods (3); furniture and wood products (5); garments, textiles, accessories, and handicrafts (7); other manufactured goods (8); scrap metal (1); and salt (1). Because of the nature of the survey, which required considerable cooperation on the part of senior management, it was not possible to chose the sample randomly. Instead it was chosen on the basis of personal contacts and known propensity for cooperation, keeping in mind the need to maintain diversity of product, size, experience, and other characteristics. The results of the survey cannot, therefore, be regarded as definitive, but rather as exploratory and suggestive.

The survey instrument, a copy of which is included in Annex C, was divided into two parts. The first, which was more qualitative in nature, was generally administered in a single

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[30] The rebate increases with share of sales for export, and is higher for agricultural exports than for manufactured exports. For example, a manufacturing firm exporting 5 to 15 percent of its sales is entitled to a rebate of 30 percent on taxable income, whereas an agricultural firm exporting the same proportion of its sales is entitled to a rebate of 40%. A firm exporting 25 percent or more of its sales is entitled to a rebate of 75 percent in either sector. Ibid, p.47.

interview with the owner or a senior manager of the firm. If the firm then agreed to cooperate further, the second part of the survey, which asked for cost and other quantitative data, was left with the respondent to be completed and discussed during a follow-up visit. In some cases, it was necessary to return to the firm several times.

The quality of the data, especially, from the second part of the survey, varied substantially. In some cases, it was necessary to complement this information with that from other sources. In the end, it was possible to estimate comparative cost and incentive indicators for 17 firms and to conduct statistical analyses for most of the 44 firms in the sample.

In this section, we first describe a number of characteristics of the sample firms included in the survey. These characteristics include age, years of export experience, value of total sales, value of exports, employment, ownership, major markets, capacity utilization, sources of finance, type of collateral used, and similar variables. We also consider the importance attached by the firm to different constraints, exemptions from or credits for taxes paid, delays in clearing exports or imported inputs, and other variables directly related to export activities. In addition to this quantitative description of the sample of firms, there is also a more qualitative discussion, including an exploration of the problems experienced in some of the major industries.

The second part of this section presents the results of a number of regression analyses that were run in order to estimate the independent effects of different variables. This permits the testing of several of the hypotheses that were suggested in the preceding section.

1. Characteristics of the Sample

a. Quantitative Description

The firms range in age from 1 to 43 years, with the mean year of registration being 1979 and the standard deviation 11 years. About half the sample first registered before 1985. Most have had little export experience -- the mean year in which the firm first exported is 1989 and the standard deviation is only 4.6. This suggests how important the reforms were in creating an environment for nontraditional exports.

The range of firm size in the sample varies considerably. The mean value of total sales is 659 million cedis, with a standard deviation of 1539 million cedis and a range from 1.3 million to 9 billion cedis. On average, exports comprise less than half of total sales, with a mean value of 272 million cedis, a standard deviation of 476 million cedis, and a range of 1.3 to 1867 million cedis. The mean number of employees is 151, with a standard deviation of 401, and a range of 2 to 2300.

Forty percent of the firms in the sample have been approved under the Investment Code. Thirty-three of the firms are wholly Ghanaian owned, and 9 are joint ventures; none is wholly foreign owned.[31]

Twenty of the firms list Europe as their principal market, while 11 firms list West Africa and eight firms list the United States. Eighteen of the firms have a foreign firm act as their distributor, two firms use a foreign firm for technical assistance, and five firms receive market information from a foreign firm. Equally interesting, 18 firms do not indicate any kind of close relationship with a foreign firm, and only six firms indicate that their foreign partner has any kind of financial stake (26 firms, however, did not reply to this question).

Nineteen out of 39 firms cite lack of capital for fixed investment as a major constraint. This is especially interesting since the mean level of capacity utilization is only 55%, with a standard deviation of 26% and a range from 8% to 100%. This suggests that much of the equipment being used is old and in disrepair.

The second most frequently cited constraint is either lack of overseas markets or lack of knowledge of overseas markets (12 firms), followed by inadequate labor skills (10 firms), and inadequate product quality (3 firms). Only two firms each list lack of working capital or unreliability of input supply as constraints, and only one firm each lists unreliable overseas importers or long delays in payment.

With respect to the use of export incentives, 12 firms have received an income tax credit for their exports, 4 firms have applied for but had not yet received a credit, 8 firms are exempt from income tax due to their investment code status, and 19 firms have not applied for a credit, in most cases because they did not know about it. On the other hand, 29 firms have received exemption from sales and excise taxes on their exports, 4 firms have not applied for exemption, and 11 firms did not respond to this question.

The mean delay in clearing export shipments is reported as 3.7 days, with a standard deviation of 3.3 and a range of 1 to 14 days. Only one firm reports that this delay has resulted in its not being able to meet an order, while three firms report other problems associated with delays. The mean delay in clearing imported inputs is much longer -- 8.9 days, with a standard deviation of 6.0 and a range of 2 to 20 days. As a result of these delays, two firms report that they have to hold larger inventories of inputs and one firm says that it is obliged to purchase more inputs locally than it would like. Despite the fact that these delays do not appear to be a major problem at the present time, they could become so as firms begin to compete more actively on the world market, where timeliness is important.

With respect to trade finance, 19 firms report that they have used either an overdraft or a loan backed by a letter of credit. Twelve firms say that they have used their own capital to

[31]All the firms did not respond to each question so that the sum of the firms in each category is generally less than the total of 44 firms in the sample. In this instance, for example, only 42 firms responded.

finance their exports, seven firms have obtained financing from overseas importers, two firms have received financing from their parent company, and three firms report other sources of financing. Nine firms report using real property as loan collateral, and three firms say that inventories have served as collateral. The average loan amount is 56 million cedis, with a standard deviation of 97 million and a maximum loan of 300 million cedis. The average loan duration is quite long -- 187 days, with a standard deviation of 247 days and a maximum duration of 999 days. Interest rates average 26%, with a standard deviation of 11% and a maximum rate of 46%.

b. Qualitative Analysis

Not all of the information obtained in the questionnaire can be quantified as easily as that described in the preceding section. It is useful, therefore, to provide a brief description of some of the problems cited, both generally and in specific industries. These industries include horticulture; marine products; garments, textiles, accessories, and handicrafts; and furniture and wood products.

i. General

Firms complain of lack of investment capital, yet at the same time they are operating at a 50-60% or lower rate of capacity utilization. One explanation is that much of the existing capital is old, in bad repair, and outmoded. Broken or outmoded equipment and the inability to easily import parts slows production and raises costs.

Another explanation for low rates of capacity utilization is the need to produce in large volumes on demand. If a seller cannot fill an order, either on a regular basis or on special command, he often loses the customer. The capacity to fill large orders is especially important when exporting to Europe or the United States, where there are important economies of scale in marketing. This requirement varies by industry. Handicrafts, which are usually sold to small-scale specialty stores, often do not require large capacity since orders tend to be relatively small. In this industry, exporters often act as middlemen purchasing from local artisans. In horticultural or marine products, on the other hand, large capacity is needed because these products are sold to large firms who prefer dealing with a few large reliable exporters rather than several small, more uncertain suppliers. Production of these products also has higher fixed costs and therefore needs to be large to be profitable.

Lack of capital for fixed investment is likely to become an increasingly important constraint on the expansion of nontraditional exports. For example, one exporter noted that pineapple operations were too capital-intensive, which is why he switched to producing yams and mangoes. As pineapple production increases, Ghanaian pineapple firms will become less competitive unless they can get access to the capital they need for fixed investment.

Most firms resort to self-financing for a large part of their financial needs. This has the advantage that they do not have to wait for bank approval, there is no uncertainty regarding their gaining that approval, and the implicit cost of using their own capital is less evident to them than the cost of borrowing.

Firms which have neither sufficient capital of their own nor confirmed, irrevocable letters of credit must put up other collateral in order to obtain loans. In most cases, this takes the form of real estate holdings. A few others have used inventories as collateral, but banks are generally unwilling to accept this in Ghana because it is difficult to guarantee the quality of these stocks in the event of foreclosure. Even real estate is less than ideal as collateral because of the difficulties encountered with and the long time required for foreclosure in the court system.

Some firms, especially in the horticulture and marine industries, say they can sell as much as they can produce. However, other products are more difficult to market, especially for those firms geared exclusively to markets in Europe or the United States. These products require higher quality with more skilled workmanship, but most firms exporting to these markets do not seem too pessimistic about lack of skilled labor, the main concern being finding a larger market. Although most business contacts are through networking, and very few are through trade fairs, there seems a desire to find more contacts through impersonal means.

Telecommunications is increasingly becoming a vital element of international trade. Firms who cannot afford fax machines, cellular phones, and other modern means of communication encounter significant barriers to international markets. All firms, however, experience major problems with telecommunications within Ghana.

Most firms in the survey do not feel that procedures regarding exports or the importation of inputs are a major barrier to nontraditional exports. Export procedures have been substantially simplified over the past few years, and clearance, which is often handled by a forwarding agent for the smaller firms, should normally take no more than three days. Most of these procedures are internationally accepted, though there are a few local requirements that should be eliminated, and others that need to be clarified, especially in view of the high degree of competitiveness that characterizes world markets.

As an example, payments must be made by exporters to the Ghana Shippers Council even though virtually all firms say that this organization provides no services. Procedures to obtain clearance for furniture and wood product exports are particularly cumbersome and costly. Guidelines regarding export procedures are often not clear. New entrants into the export sector, especially, are often bewildered by the complexity of the procedures. One firm went back and forth several times to the Board of Museums and Monuments before it was eventually told that it did not need approval from the Board. Time spent on clearing exports varies widely from firm to firm, indicating a lack of formal guidelines or knowledge of the guidelines for each industry. Import taxes on inputs are either high or there are none, which distorts profitability not only between but also within industries.

Customs officials generally receive side payments to facilitate the processing of both exports and imports. These amount to about 0.5 percent of the FOB value of exports and are probably very difficult to eliminate for the foreseeable future. Extortion of unusually high payments can occur when rapid processing is of high priority, but this does not appear to be a major problem because of the widespread understanding that exists of what constitutes a reasonable level of payment to officials.

Contract enforcement can be a problem for firms without well established linkages with foreign importers. Even domestic contracts are difficult to enforce because the judicial system in Ghana is very slow and costly. As a result, business transactions tend to be confined to those with whom a firm has personal experience or social ties.

The cost and availability of freight is a significant problem. The cost of sea freight is high and there is little effort to organize backhaul. The problem with air freight is essentially one of availability. Lack of volume means that charter planes must stop in neighboring countries, resulting in delays and deterioration of the quality of perishables.

Although exporting firms are now permitted to retain all of their earnings as foreign exchange deposits within Ghana, they are sometimes under pressure from commercial banks to convert some of their deposits into cedis, often at relatively unfavorable rates of exchange.

Few problems have been encountered with business registration procedures or labor regulations, though this is at least partly because firms tend to employ temporary labor as much as possible to avoid costly compliance with labor laws. Not all firms are aware of the income tax benefits that are available to them if they export.

A duty drawback system is in effect for imported intermediate inputs, but it is complex and hardly ever used. Duty exemption is sometimes authorized, especially for the larger firms, but there is lack of transparency regarding the criteria used, resulting in considerable potential for abuse.

There appears today to be relatively little arbitrary interference by officials at high levels in the activities of business firms. Where such interference has occurred, it has been strongly opposed by the private sector, often with success. In any event, the situation appears to be much better today than it was a few years ago.

ii. Horticulture

Across the board, horticultural exporters generally have the same characteristics and complaints. They are young firms, geared primarily to the export market. Their sales range from 30 to 300 million cedis. The firms in the sample operate between 15% and 54% of capacity. Ironically, most say that their capacity is inadequate to fill orders, but interest rates are considered too high for expansion, even if financing were available. This industry, in comparison to the others, seems much more sensitive to interest rates. Currency received from exports is almost completely converted to cedis in order to pay bills and interest charges, and to finance the next shipment.

Firms complain consistently that there is no agent on the receiving side of the shipment to verify the true amount of damage. One firm states that because 30-40% of each shipment is considered damaged, it is not worth expanding. Most firms find telecommunications within Ghana to be inadequate and often resort to messengers. Limited air cargo space means that products have to be stored in cold storage, which is costly and can result in spoilage.

Yam exporters comment that government intervention was detrimental at one point. This was in 1990, when the government mandated that they could only sell to three UK firms and at a fixed price, resulting in their having to break contracts with other clients and incurring substantial business losses. Eventually, the three UK firms went bankrupt and the yam exporters had to re-establish client ties under conditions of lower credibility.

One of the largest horticultural firms has invested heavily in communications and has solved the problem of air cargo space by purchasing its own cargo plane. Through vertical integration of production, packing, and transportation, this company has reduced some of its major risks. Furthermore, because this company is represented at the receiving end, it has no complaints of false claims against damaged goods. Few firms, however, can achieve this scale of operation.

iii. Marine Products

Marine products are similar to each other in that their market is primarily the United States and they are either large-scale producers or small firms. Similar to the horticultural sector, older firms tend to be larger. However, firms that are subsidiaries are geared almost exclusively to export regardless of age. Due to the high fixed costs associated with large-scale fishing, the firms in this industry tend to be large. Those that are small are mainly brokers who buy from local fishermen, but, without the economies of scale, they tend to be less profitable unless they are able to specialize in a niche market. One highly profitable firm, for example, buys sharksfin, a delicacy item in East Asia that appears to also be popular in Ghana, from local fishermen. The sharksfin is salted and seasoned, adding value to the primary product. In this niche market, the small scale of operations is just as, if not more, profitable than those of large trawlers. At the other extreme, the tuna companies tend to be large, to receive substantial financing from external sources, to have significant economies of scale, and to have considerable bargaining leverage with the government. When fuel prices went up in January 1993, several of these companies complained enough that the government lowered the prices.

iv. Garments, Textiles, Accessories, and Handicrafts

As with the horticultural industry sector, this sector seems to be doing quite well, and there is a general desire to expand production and exports. Unlike the marine industry, which imports most of its inputs duty free, these firms face high import tariffs (10-25%) on their imported inputs. Those firms that act as a middleman, purchasing from small-scale artisans, seem to be more profitable than those that produce the goods that they export.

Although there is some complaint of initial difficulties finding markets, once these are found, the major problem is meeting market demand. Finance is a major issue. Due to unreliable local supply, companies must maintain high inventories to meet export orders. With working capital only available locally at high rates of interest and for short periods of time, producers must often set up an arrangement with the buyers for prepayment. Letters of credit are difficult to get approved and processed -- one firm was still waiting for an LC after 5 months. Lack of financing for fixed capital means firms have to work with old, out-dated

machines whose spare parts must be imported or custom made, causing further constraints and delays in production. Other constraints include lack of technical assistance and a shortage of qualified workers.

v. Furniture and Wood Products

The furniture and wood products industry appears to be only modestly competitive under current circumstances. Under the Timber Export Development Board (TEDB), exporters must pay the same price for export quality wood that foreign customers pay. Pricing is in dollars converted to cedis at the current exchange rate. Most furniture makers cannot afford to buy the quality wood and therefore say that they cannot compete on the international market. In addition, the TEDB requires exporters to go to the Forest Product Inspection Bureau in Takoradi to receive permission to export, thus requiring the time and expense to go back and forth in order to complete an hour's worth of paperwork. This is evidenced by the firms' consistent complaints of cumbersome export procedures. Sometimes ships are missed due to paperwork, delaying product arrival for 2-3 weeks.

Another major hinderance is the banking process -- one firm said that it took seven months for the bank to confirm a letter of credit. In addition to having to wait for financing, firms have to pay their taxes in advance. No firm has ever received a duty drawback, though most have applied and have eventually ceased attempting. However, furniture firms do not appear to pay high taxes on their imported inputs. Firms did not seem constrained by market size, and all of them ship whole containers. Other constraints include lack of qualified, affordable personnel at all levels and expensive telecommunications.

2. Regression Analysis

For the sample as a whole, exports average 41% of total sales. In general, the smaller firms tend to be more specialized in producing for the export market, while the larger firms produce both for the domestic market and for export. Furthermore, with value of sales held constant, firms in the primary sector tend to export more than firms in the secondary sector. Each of these findings is confirmed by the following regression:

$$LNEXP = \underset{(.472)}{1.965} + \underset{(.460)}{.995}DPRI + \underset{(.088)}{.418}LNSALES \qquad R^2 = .447$$

where LNEXP is the natural logarithm of the value of exports;

DPRI is a dummy variable = 1 if the firm is in the primary sector;

LNSALES is the natural logarithm of the value of total sales;

R^2 is the coefficient of determination adjusted for degrees of freedom.

Figures in parentheses are the standard errors of the regression coefficients. If we were to subtract LNSALES from both sides of the equation, the left-hand side would equal LN(EXP/SALES) and the coefficient of LNSALES on the right-hand side would equal -.582, which is significantly negative and reflects the extent to which the ratio of exports to sales decreases as the value of total sales rises.

One reason for this may be the fact that the larger firms are significantly older than the smaller firms, as shown by

$$LNSALES = \underset{(71.907)}{207.607} - \underset{.036)}{.103}YREG \qquad R^2=.152$$

where YREG is the year in which the firm was first registered. The older firms are more likely to have been established to produce first for the domestic market and subsequently for export as well; the younger firms tend to be established with the export market principally in mind. Attempts to test the independent influence of YREG on LNEXP were inconclusive, however, suggesting that this effect, operates primarily through the spillover of total sales by larger firms onto the export market.

Overseas markets are concentrated in Europe, the United States, and West Africa. Twelve firms export to the United Kingdom, 7 to Germany, 13 to the rest of Europe, 13 to the United States, 11 to West Africa, and 5 to other areas. Horticultural products, wood products, handicrafts, and textiles and garments are exported mostly to Europe and the United States; tobacco goes to the United Kingdom; marine products are exported primarily to the United States, and cola nuts, salt, oil palm, and other manufactured products are exported principally within West Africa. Contrary to what was expected, firms exporting to the West African market actually have significantly larger total sales and employment than do firms that do not export to this market. Yet there is little difference in the mean value of exports between the two groups. This suggests that most regional trade occurs as sales of the larger, older firms spill over beyond national boundaries, while the smaller, younger firms find niche markets outside of Africa.[32]

The constraint on nontraditional exports most frequently reported by firms is lack of capital for fixed investment. Nineteen out of 39 firms say that this is a major constraint. Yet many firms report low rates of capacity utilization, and the relationship between percentage utilization of capacity and lack of fixed investment capital, though positive, is relatively weak ($t = 1.698$). The hypothesis was tested that this constraint is more important for smaller than for larger firms, because of the lack of experience of the former in dealing with lending institutions, but total sales, exports, and employment are actually greater for firms that report this as a constraint than for the others. This supports the impression gained from informal interviews that the most important problems regarding nontraditional exports are on side of production rather than demand. Firms frequently state, in fact, that they have far more orders than they can fill.

Smaller firms are often forced to use their own capital because they lack the volume of shipments necessary to make profitable use of traditional instruments of trade finance such as letters of credit. Among the sample firms, 19 have financed their exports through overdrafts or loans backed by letters of credit (LCs) , 7 have obtained financing from overseas importers, 12 have used their own funds, and 4 have obtained financing from other sources. The mean value

[32]This finding is consistent with the results reported in World Bank and USAID, *Building a Competitive Edge*.

of exports for the firms that have obtained letters of credit is 358 million cedis, whereas this value is 187 million cedis for firms that have not obtained LCs. Despite this difference in mean values, however, the variances are quite large and the difference is not statistically significant (t = 1.11).

The next most frequently cited constraint is lack of overseas markets (9 firms) or lack of knowledge of these markets (4 firms). This constraint does not seem to be related in any way to size of firm (t = .28 for sales, t = 1.14 for exports, t = .42 for number of employees). On the other hand, those firms that export to the West African market are significantly larger (t =2.56 for sales, t = 2.26 for number of employees), but are not especially oriented towards exports (t = .21 for exports).

D. Comparative Cost and Incentive Analysis

1. Methodological Approach

Indicators of domestic resource costs (DRC), nominal rates of protection (NRP) for outputs and inputs, effective rates of protection (ERP), and effective rates of subsidy (ERS) were calculated applying the standard methodology and using data acquired in the second part of the survey. These indicators were then adjusted for institutional costs that were identified and measurable.

Most of the adjustments involved calculating the implicit export tax rate that results from (1) the imputed cost of unnecessary labor involved in processing export shipments, (2) the unnecessary cash costs involved in processing exports, including fees paid to organizations which rendered no services, and (3) the cost of having to convert 65% of foreign exchange earnings through the banking system rather than through the foreign exchange bureaus. Since most firms reported their export sales revenue in cedis converted at the bank rate of exchange, this value was adjusted upward to take into account the value of foreign exchange on the forex bureau market. The labor and cash costs associated with complying with unnecessary procedures were subtracted from the cost of nontradables.

An implicit tax on imported imports was calculated on the basis of (1) the imputed cost of unnecessary labor involved in processing import shipments, (2) the unnecessary cash costs involved in processing imports, and (3) the imputed capital costs resulting because of delays in processing imports. These costs were subtracted from the cost of nontradables and were considered instead as a tariff equivalent on imported inputs.

2. Results

The results of the analysis are shown by product line in Table III-3, which presents the comparative cost and incentive indicators both with and without the costs and disincentives introduced by the institutional constraints discussed above. The table shows the total value of export sales (for 1992, generally), the implicit export tax rate resulting from institutional barriers

(the explicit export tax being zero), and the DRCs, NRPs on outputs and inputs, ERPs, and ERSs.

The wide range of scale of operations is evident from this table. The largest export sales, made by an oil palm firm, comprised 3.8 billion cedis. At the other extreme, the exports of one of the garment firms totaled only 1.1 million cedis. There is no significant relationship between the value of export sales and the other variables in the table.

The implicit export tax rates resulting from the institutional barriers cited above are not huge, but they are nonetheless significant. Each of the firms for which cost data are available is penalized by at least 2.9% of the FOB value of its export sales because of these barriers. In some cases, the cost is much higher, rising to a maximum of 16.2%.

These implicit taxes must be considered in the light of several factors related to exports. The first is that, in contrast to import-competing industries, nontraditional export markets are highly competitive. Over the longer run, there is very little fat in the cost structures of most products. Competitiveness depends on keeping costs to a minimum. An equivalent export tax of 5% to 15% can be critical to whether an industry survives. Second, there is already a substantial bias against exports in Ghana because import tariffs result in substantial protection for the import-competing sector vis-a-vis exports. They also cause the cedi to be overvalued, biasing incentives against both export and import-competing activities in favor of the nontradables sector (see Chapter V). These biases are unavoidable in Africa today because of the difficulty of collecting a substantial portion of public revenue from direct taxes, but they make it imperative that all other impediments to export trade be minimized.

The DRC results suggest that most of the products being exported are profitable (DRC < 1), and some of them are highly so. This is especially true after adjustment is made for the cost of institutional constraints. These adjustments include: (1) correcting the value of export sales for undervaluation due to the lower rate at which 65% of export earnings had to be converted from foreign exchange into cedis, and (2) subtracting out the costs of labor and capital associated with institutional constraints that can be removed.

Examples of profitable or nearly profitable exports include pineapples, shellfish, tuna, jams, furniture, wood products, garments, handicrafts, mats and carpets, aluminum products, stationary, and gas products. The pineapple company that is not profitable and shows a relatively high DRC has just started operations, so its unit costs should come down in the future. The other pineapple exporter, on the other hand, has been in the business for a long time so that its DRC probably is a reasonable approximation to that of the entire industry. Because the DRC is so close to one for pineapples, and probably other horticultural products, there is a need to watch costs carefully so as to maintain international competitiveness vis-a-vis numerous other suppliers. The same applies to a lesser extent to exports of shellfish and tuna.[33]

[33]The tuna exporter in Table III-3 with the DRC greater than one was going through a transition period in 1992 and is probably much more profitable today.

TABLE III-3
COMPARATIVE COST AND INCENTIVE INDICATORS

Product	Export Sales (000s cedis)	Implicit export tax rate	DRC	Adjusted DRC	NRP output	Adjusted NRP output	NRP input	Adjusted NRP input	ERP	Adjusted ERP	ERS	Adjusted ERS
Pineapple	23111	3.1%	1.26	1.21	0%	-3%	5%	5%	-4%	-9%	-8%	-13%
Pineapple	134151	4.9%	1.05	1.00	0%	-5%	10%	10%	-5%	-12%	-9%	-15%
Oil Palm	3825000	3.0%	1.08	1.05	0%	-3%	9%	9%	-5%	-9%	-7%	-11%
Leaf tobacco	356800	6.2%	1.29	1.22	0%	-6%	18%	19%	-7%	-15%	-9%	-16%
Shellfish	47300	2.9%	0.81	0.79	0%	-3%	11%	11%	-6%	-11%	-9%	-13%
Tuna	961119	2.9%	1.14	1.10	0%	-3%	22%	22%	-16%	-20%	-18%	-21%
Tuna	1144875	2.9%	0.74	0.73	0%	-3%	19%	19%	-5%	-8%	-6%	-9%
Jams	18350	7.8%	0.74	0.67	0%	-8%	23%	23%	-5%	-14%	-5%	-14%
Furniture	1400000	3.9%	0.92	0.89	0%	-4%	27%	27%	-13%	-18%	-16%	-21%
Wood products	225000	16.2%	1.15	1.02	0%	-16%	20%	20%	-5%	-24%	-9%	-25%
Garments	1127	8.1%	0.47	0.41	0%	-8%	18%	18%	-5%	-15%	-12%	-21%
Garments	10000	7.2%	0.17	0.12	0%	-7%	39%	39%	-10%	-19%	-11%	-19%
Handicrafts	99270	8.8%	0.84	0.77	0%	-9%	31%	31%	-6%	-16%	-6%	-15%
Mats/Carpets	264000	6.9%	0.69	0.61	0%	-7%	36%	36%	-30%	-40%	-30%	-40%
Aluminum products	354445	15.0%	0.69	0.47	0%	-15%	7%	7%	-6%	-34%	-12%	-37%
Stationery	266218	7.7%	0.64	0.51	0%	-8%	18%	19%	-24%	-39%	-27%	-46%
Gas products	6087	10.8%	0.34	0.22	0%	-11%	19%	19%	-11%	-27%	-11%	-27%

Note: DRC - Domestic resource cost
NRP - Nominal rate of protection
ERP - Effective rate of protection
ERS - Effective rate of subsidy

Among industrial goods, Ghana appears to have a significant comparative advantage in processed foods, such as jams, which contribute value added to primary production. Furniture and wood products are also reasonably profitable, but costs can be an important consideration, as shown by the fact that for wood products the unadjusted DRC is substantially greater than one while the adjusted DRC is almost equal to one. Garments and handicrafts are rapidly growing industries for which exports are very profitable and should be strongly encouraged. Other products such as mats and carpets, aluminum products, stationary, and gas products are quite profitable at present, but, because their major market has been the CFA countries, there may be some decline in their exports following the devaluation of the CFA franc in January 1994.

Other export producers are having a tougher time, e.g., oil palm, leaf tobacco. In some instances, high DRCs may be the result of transitory events, as when a new firm is just starting up, but in other cases it appears to be due to fundamental factors shaping the structure of comparative advantage. For example, it is unlikely that Ghana will be able, in the foreseeable future, to produce very profitably oil palm products for export. For one thing, agro-ecological conditions in West Africa are not as favorable for oil palm as in southeast Asia, which is Africa's strongest competitor. For another, the oil palm industry was established as a substitute for imports, and it is not always easy to turn such an industry around to export. Finally, the major market for these exports has been in the CFA countries, and this market may diminish following devaluation. The leaf tobacco industry may also be experiencing agro-ecological difficulties, but more needs to be learned about the problems that this firm faces. What is perhaps most surprising, however, is how few unprofitable export industries there seem to be.

Since there are no formal export taxes, the nominal rate of protection for output is zero in each case. This is then adjusted for the implicit export tax rate to obtain the adjusted NRP, which is less than one, showing a disincentive to export on the output side ranging from -3% to -16%.

The unadjusted NRP for inputs is positive and much higher, ranging from 5% to 39%. This is because there is no workable system in effect to exempt producers of nontraditional exports from paying taxes, either directly or indirectly, on imported intermediate goods and on nontradable inputs such as electricity and transportation. Unlike the producer of import-competing products, the exporter receives no positive protection to compensate for this negative protection the use of inputs. The NRP for inputs is quite high for leaf tobacco, tuna, jams (processed foods), furniture, wood products, garments,[34] stationary, and gas products industries, rendering these less competitive. The adjusted NRP, which also takes into account the disincentive that results from the labor and capital tied up in clearing imported inputs, differs little from the unadjusted NRP.

The net result of all of these factors is relatively high negative adjusted rates of effective protection and effective subsidy. The adjusted ERP, for example, varies from -8% in the tuna

[34]The difference in the NRP on inputs for the two garment firms is due to the fact that one uses mostly imported cloth (the one with the higher NRP) while the other purchases a substantial amount of its cloth on the local market. The two types of cloth are not identical, so the local cloth is treated as a nontradable in the analysis.

industry down to -40% for mats and carpets. It is highly negative for leaf tobacco, unprofitable tuna, furniture, wood products, garments, handicrafts, mats and carpets, aluminum products, stationary, and gas products. The value of this indicator depends mostly on the importance of institutional constraints affecting output incentives, the weight of imported inputs in total production, and the rate at which inputs are taxed. With few exceptions, the table suggests that exports are heavily penalized by a combination of institutional constraints and taxation of imported inputs. This is in strong contrast to import competing products, which undoubtedly have ERPs that are substantially in excess of one. The adjusted effective rate of subsidy, though slightly different in magnitude, paints a very similar story. Thus the bias against nontraditional exports is very important and needs to be taken into consideration in policy discussions.

E. Policy Conclusions and Recommendations

The analysis of the survey data, coupled with the earlier description of the institutional environment, enables us to draw a number of policy conclusions. Foremost among these is the fact that a combination of taxation of imported inputs, either directly or indirectly through taxes on the tradable content of locally supplied inputs, plus the cost of various institutional constraints, results in a substantial disincentive to production for export. Effective rates of protection range from -8% to -40%. Given that most import competing activities have effective rates of protection that are positive and substantially above zero, this implies a very large bias against exports. Removing as much of this bias as possible should be a major policy priority.

Many new entrants into the nontraditional export field have little experience with exports and frequently are in need of assistance in learning about the various administrative procedures involved. Beyond this, however, even the older, more experienced exporters incur significant costs in complying with these procedural requirements. The result is a significant barrier to exports. The following specific requirements seem to be questionable, based on experience in other countries:

1. The gaining of commercial bank approval of the A2 Form and the charging the exporter 1% or more of the FOB value of exports for processing the form and handling the foreign exchange transaction is difficult to justify in light of the movement towards a unified, flexible exchange rate. Data requirements can be satisfied if the firm simply submits the form to Customs at the time that the goods are cleared for export.

2. Membership in the Ghana Shippers Council should be optional and should not be a requirement for exporting.

3. The requirement that exporters of furniture and wood products obtain the approval of the Forest Products Inspection Bureau serves no reasonable purpose and imposes a very large burden on exporters of these products. It should be eliminated. The same recommendation applies to the need for handicraft exports to be approved by the Museum and Monuments Board.

4. The requirement that exporters and importers should obtain an Income Tax Certificate each time that they send or receive a shipment should be eliminated.

Some way must be found to improve duty-free access by exporters to imported intermediate inputs. This is the second important area in which incentives are biased against exports. Bonded warehouses may work for some of the larger firms, but smaller firms are much less able to take advantage of this mechanism. The establishment of a special fund to be used to pay duty drawback may help, but procedures need to be simple and the process efficient. The building up of a set of coefficients indicating the indirect as well as the direct content of imported inputs in the exported goods would be highly desirable. Consideration should also be given to providing tax exemptions for imported inputs at the time of importation based on each firms export performance in previous years. This could be combined with the duty drawback system so that the firm could still claim a rebate for duties and taxes paid on imports in excess of the exemptions received and on inputs purchased locally.

All of this will require an efficient system of record keeping by individual firm. The basis for this system already exists in the Automated System for Customs Data (ASCUDA), which has recently been made operational at Tema, Takoradi, and the airport at Accra. This system maintains individual firm records that can be used to verify which duties and taxes have been paid, which exemptions have been received, and what each firm has imported and exported. Most of this information will be required anyway once the value added tax is introduced.

While the average delay in clearing exports through the ports or airport may not be excessive, some firms do experience excessive delays and the time required for clearing imported inputs is definitely too long. Reducing these delays has been an important factor in Asia in increasing export competitiveness. In Singapore, the introduction of Electronic Data Interchange (EDI) at the port reduced customs clearance time to 15 minutes. Computerization could have a similar effect in Ghana. This is only one element in the overall need to improve quality and timeliness.

A number of firms appear to be either unaware of export incentives that are available or they are unwilling to use them because of the complicated procedures involved. The former is true of the partial income tax rebate, while the latter occurs with the duty drawback scheme and sometimes with the sales and excise tax exemption. It is important that export incentives be simple and transparent if they are to be used, especially by smaller firms. They also need to be widely publicized.

The same is true of approvals for investment code status and land registration. Although steps are being taken to simplify the approval process under the new investment code and to make the Ghana Investment Center more promotional and less regulatory, it is as yet unclear how effective these efforts will be. As far as land registration is concerned, there is great need for much better publicity regarding the steps to be taken since registration may require up to two years or more and mistakes can be very costly.

The most important constraint noted by the firms in the survey is finance, especially for fixed investment. Firms frequently state that they have more orders than they can fill. This constraint exists for all sizes of firms. Although substantial progress has been made in recent years in restructuring the banking sector and in making more working capital available, little has been done to increase the availability of capital for renewal and expansion of plant and

equipment. The situation is aggravated by the government and central bank issuing bills and bonds that carry very high rates of interest (up to 35%) and are the preferred investment for many financial institutions. This area deserves high priority. The establishment of the Eximguaranty Company and the Ghana Leasing Company may be steps in the right direction.

Lack of working capital is also likely to become an increasingly important constraint as the nontraditional export sector expands. This is especially a problem for smaller firms. Measures must be taken to assist these firms in applying for loans from the commercial banks. The opening of the Export Finance Office and the Eximguaranty Company should aid banks in extending the range of their pre- and post-shipment financing to at least some of the smaller firms.

Lack of sufficient skilled workers also appears to be a problem, the solution to which will require innovative training programs. These programs should be managed by the private sector, which understands best what specific skills are required. Some public subsidization of the programs would be desirable because the firms running the programs are not able to capture all the benefits.

The requirement to go through the Ministry of Labor for the recruitment of labor is onerous and discourages the hiring of workers on a permanent basis. Instead workers are hired temporarily to avoid this requirement and the problems and expense involved in retrenchment. It is recommended that the requirement for firms to go through Public Employment Centers when hiring workers should be eliminated and that they should instead be required simply to inform the Labor Office of the hiring of new employees. It is also recommended that labor disputes and the retrenchment of workers, when necessary, be settled within the context of collective agreements and that parties have access to courts for settlement of differences.

Contract enforcement is a significant problem since the judicial system, which is slow and costly, is rarely used for the resolution of disputes. This undoubtedly inhibits the establishment and growth of firms, which must depend on informal means of enforcement, but to what extent is unclear. Insofar as contracts with overseas importers are concerned, there is a need to explore alternative means of contract enforcement, such as use of surveyors and factoring agents, and to ascertain the degree to which these alternatives are cost effective. Efforts to assist firms in establishing linkages with foreign partners would also alleviate the problem of contract enforcement overseas.

The cost and availability of sea and air freight depends very much on the volume of exports. Reducing sea freight costs will require greater volume and taking better advantage of potential backhaul rates. Larger volume would also lower air cargo rates by allowing cargo planes to ship full loads from Ghana.

Telecommunications is a major problem both within Ghana and with other countries. A major overhaul of the system is planned, but in the meantime companies may want to take advantage of cellular phones and other systems which do not depend on central telecommunications infrastructure. This is a very important priority for improving quality and timeliness of delivery.

. Few firms mentioned any instance in which there was arbitrary interference by officials in high places in the firm's activities. Although this problem is not unknown, it does not appear to be a major impediment to the growth of nontraditional exports. Certainly the situation is much better today than it was a few years ago.

On the other hand, it is clear that the legal and judicial system that underlies commercial dealings in the industrial world plays a much less important role in Ghana, and probably in the rest of Africa as well. Firms have to depend to a much greater extent on their personal experience, on the reputation of firms with which they enter into business dealings, and on the family and other social ties that enable to exert some control over the fulfillment of business obligations. Although not widely perceived by firms as being an important constraint in Ghana today, the lack of a well functioning legal and judicial system is likely to become increasingly important as the scale of activity increases and as business dealings become more impersonal. Furthermore, the current system works very much in favor of the larger firms and inhibits the growth of smaller, more dynamic enterprises.

IV. MADAGASCAR CASE STUDY

A. Introduction

Madagascar was chosen as a country for testing the methodology used in the study for two reasons. First was the comprehensiveness of its economic reform. The national investment program of the 1970s (known as *investir à outrance*) had been financed largely through external borrowing rather than internal savings. The result by the early 1980s was a large balance of payments deficit and spiraling inflation. This situation spurred the Ratsiraka government to launch a series of measures in 1982 which were designed to stabilize the economy and prepare for structural adjustment. Improving demand management through control of the budget deficit and restrictions on bank credit was accompanied by reform measures on the supply side, the centerpiece of which was the liberalization of rice marketing.[35] Reform continued throughout the 1980s and included devaluation, elimination of import quotas, abandonment of most export taxes, privatization of the financial sector, establishment of a new investment code to attract foreign direct investment, and the creation of a *Zone Franche* to promote exports.

Second, Madagascar is poised for strong export growth. Its comparative advantage on world markets stems from a wealth of natural and human resources. Its varied ecological and geological conditions and its southern hemisphere location give it a strong comparative advantage in a variety of niche products in the agricultural, livestock, marine, forestry, and mining sectors. The labor force is also relatively inexpensive. Table IV-1 provides data on the average monthly wages, valued at official exchange rates, for several export sectors in Madagascar as well as a number of other countries. The data clearly indicate that even compared with some of its African rivals, Malagasy labor costs are extraordinarily low, providing a strong incentive for the production of labor-intensive products for export. If valuation were to occur at the new exchange rate after the FMG was floated in May 1994, labor costs would be lower still.[36]

It is clear that the international business community is responding to these incentives. New investment and the increase in the number of new enterprises since the passage of the investment code and *zone franche* legislation has been marked. Investments under the Code have increased from an estimated FMG 23 billion in 1990, when the Code was passed, to 81 billion in 1992.[37] The number of enterprises obtaining *Zone Franche* status increased from 11 in 1990 to 53 in 1992. Many of these firms have generated employment for hundreds of Malagasy citizens.

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[35] Democratic Republic of Madagascar (DRM), *Policy Framework Paper 1990-92* prepared by the Malagasy authorities (in collaboration with the staffs of the World Bank and the International Monetary Fund), May 23, 1990; Clive Gray, J. Dirck Stryker, and Jeffrey Metzel, *The Current Macro Economic Situation and the Progress of Economic Reform in Madagascar*, Prepared for the U.S. Agency for International Development, HIID and AIRD, January, 1991.

[36] Following the move in May 1994 to a floating Malagasy franc, with the exchange rate determined through interbank buying and selling each day, the FMG depreciated from about 1900 FMG/$US to about 3500 FMG/$US.

[37] Ministère de l'Industrie et de l'Artisanat, Direction de l'Industrie, 1993.

TABLE IV-1
COMPARATIVE MONTHLY WAGE RATES

		Local Currency	U.S. Dollars
Madagascar (FMG 1992)			
Manufacturing		57,700	$ 32
Agro-industry		73,000	41
Forestry		83,300	46
Mining		76,300	42
Other Countries (nonagricultural wages, 1990)			
Ghana (1988)	(cedis)	21,411	105
Kenya	(shillings)	3064	134
Malawi	(kwacha)	177	65
Mauritius	(rupees)	3252	219
South Africa	(rand)	1654	639
Costa Rica	(colones)	24,776	271
Canada	(Canadian dollars)	2019	1731

Source: AIRD estimates for Madagascar from enterprise survey; 1993 ILO Yearbook (wage data); IMF, *International Financial Statistics* (nominal exchange rates).

Note: wages converted to U.S. dollars at nominal exchange rates.

Some of the results of this new investment can be seen in the export data presented in Table IV-2. Most relevant are the figures expressed in SDRs, since these correct for the effects of domestic, if not international, inflation. The figures suggest that, overall, there was some moderate expansion of nontraditional exports until 1992, followed by a sharp decline. Much of this decline can be contributed to the political uncertainty of the period from mid-1991 until the end of 1993.

Of greater interest are some of the product trends, especially if we ignore the last two years of political uncertainty. Among the products showing strong upward movement from 1989 to 1991 are dried beans, butter beans (*pois du cap*), luxury rice, sisal, cotton fiber, cocoa, live cattle, meats and offals, shrimp, other seafood, canned fruits and vegetables, petroleum products, wood products, garments, and other products not specifically defined. To these we can add litchis, raphia, medicinal plants, and tobacco products, which have done quite well since this period. These are the products in which Madagascar would appear to have a significant comparative advantage and in which most investments are being made.

TABLE IV-2
NONTRADITIONAL EXPORTS, 1989-93

	million current FMG					thousand current SDR				
	1989	1990	1991	1992	1993	1989	1990	1991	1992	1993
Legumes	5554	7427	9346	7132	5572	2702	3664	3722	2717	2085
dried beans	1450	2531	3217	2161	2342	705	1249	1281	823	876
butter beans	3680	4442	5626	4917	3092	1791	2191	2240	1873	1157
groundnuts	424	453	502	54	139	206	224	200	20	52
Dried Cassava	47	1410	872	0	453	23	696	347	0	170
Spices	8020	4316	6750	5865	6560	3902	2129	2688	2234	2455
pepper	5054	3134	4484	4152	4556	2459	1546	1786	1582	1705
cinnamon	2965	1182	2266	1713	2004	1443	583	902	652	750
Cereals	5212	6921	4327	1323	7349	2536	3414	1723	504	2750
luxury rice		297	597	1062	701	0	146	238	404	262
ordinary rice		0	1	2	746	0	0	0	1	279
maize	5212	6624	3729	260	5903	2536	3268	1485	99	2209
Fresh Fruit	6640	5016	7545	10093	12380	3231	2475	3004	3845	4633
litchis	6462	4927	7405	9563	12204	3144	2431	2949	3643	4567
other	178	89	140	530	176	87	44	56	202	66
Fiber	8532	9265	15717	6773	8932	4151	4570	6259	2580	3343
raphia	1587	1647	2063	3374	3902	772	812	821	1285	1460
sisal fiber	4312	7039	5763	3399	5030	2098	3472	2295	1295	1882
cotton fiber	2633	580	7892	-	-	1281	286	3143	0	0
Medicinal Plants	2766	288	3592	4304	4052	1346	142	1430	1639	1516
Cocoa	3611	3656	7275	4662	6874	1757	1803	2897	1776	2572
Livestock Products	6017	6569	10685	10272	11891	2928	3240	4255	3913	4450
live cattle	1881	3559	4891	1605		915	1756	1948	611	0
meats and offals	410	32	1540	5440	7396	199	16	613	2072	2768
hides and skins	3727	2977	4255	3227	4495	1813	1469	1694	1229	1682
Seafood	56417	1038	92507	88535	92257	27450	30109	36838	33724	34524
shrimp	48889	50381	74772	70581	76410	23787	24853	29776	26885	28594
other	7529	10656	17734	17954	15847	3663	5257	7062	6839	5930
Fats and Honey	330	872	388	557	809	160	430	155	212	303
Sugar and Molasses	38595	30860	20261	17738	12951	18779	15223	8068	6757	4847
Canned Fruits, Vegs	284	181	1817	1974	2642	138	89	724	752	989

Bran, Oilseed Cake	662	435	475	472	655	322	215	189	180	245
Tobacco Products		115	86	855	279	0	57	34	326	104
Mineral Products	61928	65367	63248	55303	52200	30132	32245	25186	21066	19534
chrome	31083	18508	17288	14374	14792	15124	9130	6884	5475	5535
petroleum products	8662	14994	20552	17413	16331	4214	7396	8184	6633	6111
industrial stones	4262	5784	5137	6290	4875	2074	2853	2046	2396	1824
other	17920	26082	20271	17227	16202	8719	12866	8072	6562	6063
Essential Oils	4978	4870	5360	5718	6482	2422	2402	2135	2178	2426
Wood Products	2794	2809	5802	6700	6485	1359	1386	2310	2552	2427
Textiles, Garments	30888	29999	55936	46083	32803	15029	14798	22275	17554	12275
sisal twine	1405	2052	946	1842	1147	684	1012	377	702	429
cotton cloth	21346	12931	24972	17610	13850	10386	6379	9944	6708	5183
t-shirts, shirts	2077	5471	7951	9877	10502	1011	2699	3166	3763	3930
other	6060	9545	22068	16752	7304	2948	4708	8788	6381	2733
Other	27933	46111	68440	54352	73203	13591	22746	27254	20704	27394
Total	271207	287526	380430	328711	344829	131959	141835	151494	125211	129041

Source: Banque des Données de l'Etat

Despite these successes, the mixed record on nontraditional exports overall, including very poor performance in some sub-sectors, raises questions regarding the constraints that these exports are experiencing. Partly the poor performance is due to the fact that some of the more dynamic industries, such as the labor-intensive garment industry, are not yet important enough in the figures to influence substantially the overall level of exports. But there are also more basic problems of poor transportation and telecommunications infrastructure, long distances from major markets, high freight rates, and lack of linkages between overseas markets and domestic production. In addition, there are numerous institutional constraints associated with administrative processing of exports and imports, controls on exporters' use of foreign exchange, implementation of duty and tax exemption schemes, access to financing, labor regulation, contract enforcement, and any number of other areas related to export trade.

In order to identify and measure the cost of the more important of these institutional constraints, extensive use was made of existing documentation, and informal interviews were conducted with public officials and private professionals involved in the export trade. In addition, a survey was administered, under sub-contract, to a sample of 34 exporting firms by the Office Statistique et Informatique pour la Programmation du Développement (OSIPD). The first part of this survey was qualitative in nature and was designed to obtain information about the firms and to identify which institutional constraints they consider to be most important. The second part was used to quantify some of these variables so as to permit the use of statistical analysis. Finally, the third part of the survey, which was satisfactorily completed by 14 of the firms, provided the quantitative information on costs that was used to estimate comparative costs and incentives indicators and to adjust these for institutional costs. The questionnaire is presented in Annex D.

This chapter on Madagascar is arranged in six sections. Section B outlines the salient features of the legal, regulatory, and judicial environment, as well as other constraints in Madagascar affecting exporters. Section C provides some details of the sample, reports statistics for the key variables in the survey, discusses qualitatively some of the problems highlighted by the survey, and presents the results of the econometric analyses. Section D presents the indicators estimated for the comparative cost and incentives analysis, showing indicators for each firm before and after accounting for institutional costs and distortions. The subsequent section fills out the data analysis with case studies, revealing both the economic promise and the institutional burdens of firms operating in Madagascar. Finally, Section F outlines implications for policy.

B. Institutional Environment

1. Special Incentives

Many exporting firms in Madagascar fall under one or both special incentive programs that are available: the *Côde des Investissements* and the *Zone Franche*.

a. Code des Investissements

The *Code des Investissements* (or "Code") was created in 1989 to encourage investments in the private sector. The primary goals of the Code are (1) to encourage the creation of new enterprises, (2) to promote expansion, quality improvements, and business diversification of existing enterprises, and (3) to encourage rehabilitation projects.

Under the Code, a broad range of industries and investment activities may be awarded preferential status.[38] These include handicrafts, manufacturing, mining, energy and water, transportation, veterinarian services, medical care, housing, land development, agriculture, livestock, forestry, crafts, fishing, shipping, and telecommunications. The range of activities and sectors encompasses almost all investment activities, but particularly those which contribute to the economic and social development of Madagascar.

All firms qualifying under the Investment Code pay a minimum 10% import tax on equipment, materials, construction materials, factory accessories, office materials, and information necessary for the implementation of the investment project. They are exempt from the payment of the *taxe unique sur les transactions* (TUT).[39] These reductions and exemptions only apply to those purchases made specifically for the investment project.

Small and medium-sized businesses receive preferential treatment over larger firms. To receive status as a *Petite et Moyenne Enterprise*, the firm must have fixed assets of less than or equal to 500

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[38] Ministère de l'Industrie et de l'Artisanat, *Code des Investissements*, République de Madagascar, December 1992.

[39] See the discussion below on how the TUT has changed recently.

million FMG and labor costs of less than or equal to 25 million FMG.[40] The major difference in benefits between small and medium firms and other firms is the percentage of tax reductions received, and the duration that the firm receives them. Benefits apply for 10 years for investments aimed at establishing an enterprise, and for 5 years for investments aimed at expansion or rehabilitation. All small and medium-sized firms receive exemption from the *taxe de publicité foncière* on loans for applicable investments, as well as on guarantees for credits from foreign sources.

For investments leading to the creation of a new enterprise, small and medium firms receive total exemption on import and sales (TUT) taxes related to the use of working capital for up to three months; exemption from the *taxe professionnelle* for the first five years; exemption from the real estate registration fee for applicable real estate; and total exemption on taxes on profits and income for the first five fiscal years, with reduced rates for the next five (see Table IV-3).

TABLE IV-3
INCOME/PROFIT TAX RATE DEDUCTIONS FOR NEW ENTERPRISES UNDER THE INVESTMENT CODE

Year	Small and Medium firms	Large Firms
1st-5th	100%	100%
6th	90%	75%
7th	80%	50%
8th	60%	25%
9th	40%	n/a
10th	20%	n/a

Source: Ministère de l'Industrie, et de l'Artisanat, *Code des Investissements*, 1992.

For small and medium firms investing in expansion, quality improvement, or diversification of activities, the following benefits apply: reduction of taxes on profits and income equal to 75% of the amount invested; exemption from the real estate registration fee; and exemption from contribution fees.[41]

Larger firms, not qualifying for *Petite et Moyenne* status, also receive benefits according to investment goals. Benefits apply for 8 years for start-up enterprises and 5 years for expansion, quality improvement, or diversification investments. New large firms receive exemption from import and sales (TUT) taxes related to the use of working capital for the first three months of operation; exemption from the real estate registration fee; 50% reduction in contribution fees; 100% exemption from profit or income tax for the first five years, and a continuous reduced rate for the next three years; and exemption from the *taxe sur la publicité foncière* on bank loans and credit guarantees.

[40] These amounts are revised annually to account for the change in the foreign exchange value of the franc Malgache; these figures pertain to 1991.

[41] The Code does not resolve a problem in investment laws dating to 1972 which distinguish between resident foreigners and non-resident foreigners, limiting business expansion severely for non-residents.

For investments in expansion, quality improvement, and diversification, large firms receive a reduction of taxes on profit and income equal to 75% of the amount invested; a 50% reduction in real estate registration fees; a 50% reduction in contribution fees; and a 50% reduction on the *taxe sur la publicité foncière* on loans and credit guarantees.

For rehabilitation projects, both small and large firms receive the reduction of taxes on profits that is incorporated in the general tax code. Large firms also receive a 50% reduction on the *taxe sur la publicité foncière* on loans and credit guarantees. Small firms automatically have this benefit.

As part of their requirements for continuance in the program, all firms must submit semi-annual reports on the progress of their investments. After the start-up phase for new investments, the enterprise must submit other reports and documents to the authorities which ensure compliance with the agreement.

Experience with the Code has revealed its complexity and the long length of time needed to comply with all of its procedural requirements. Major problems have been experienced in obtaining *cartes de séjour* and employment authorizations, in different interpretations of the Code by different ministries, and in insufficient diffusion of information regarding availability of and criteria of eligibility for financing. The establishment of a *guichet unique* in 1994 could facilitate the approval process or it could simply add another layer of bureaucracy.[42]

Because of the difficulty of ensuring that the tax benefits associated with Code status are not abused, the Code is being modified to allow firms to receive these benefits only after the investments have been made. Upon presentation of documentary evidence regarding the investment, firms will be eligible to receive tax refunds in the form of reimbursements, transfers, or credits against current or future taxes owed. It remains to be seen whether this legislation will be enacted and, if so, how effectively it will be implemented.

b. Zone Franche

Created in 1989 and amended several times since, the *Zone Franche* (the "Zone") is designed to encourage exports and foreign investment. Zone firms fall under one of four types of enterprises: 1) promotion-exploitation enterprises (EPE), which are firms responsible for management and construction work; 2) manufacturing firms; 3) service firms; and 4) firms developing primary resources. Firms are technically supposed to be located within a geographic *Zone Franche Industrielle* (ZFI) determined by local and regional governments. However, for practical purposes, Zone firms may be located anywhere with local approval; the "Zone" is a legal concept, not a geographic one.

To qualify for the *Zone Franche*, firms must fulfill certain criteria. An EPE must be able to prove its technical and financial capacity to contribute to the development of a ZFI. Manufacturing firms must devote their entire production to exports and satisfy particular criteria according to specific

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[42]Cabinets Madeleine Ramaholimihaso Manamihaso, "Le Guichet Unique," *Bulletin de Reflexion, d'Information et d'Etudes Financières, Comptables, Juridiques, Fiscales, Economiques*, No.39, March 1993, pp.15-16.

sectors. Service firms must also "export" their product, i.e. provide services only to foreign entities or to other Zone companies.

The main fiscal benefits and regulations for the Zone include tax holidays, customs concessions, and special privileges with respect to maintaining foreign exchange accounts.[43] First, all firms in the *Zone Franche* are subject to a fixed 10% IBS, or corporate profits tax (*impôt sur les bénéfices des sociétés*). However, EPE firms are exempted for a period of 15 years, manufacturing and primary resource firms are exempted for 5 years, and service industries are exempted for 2 years. After this grace period, firms receive a reduction on profits taxes equivalent to 75% of their new investment. Second, all firms are subject to a fixed tax of 10% on distributed dividends. Third, EPE firms who supply their own network for electricity, water, or telecommunications are exempted from the sales tax and the *taxe unique sur les transactions* (TUT). Finally, there is a 35% tax rate ceiling on expatriate salaries.

Zone firms also receive special customs concessions. Inputs for the construction, preparation, or implementation of an enterprise in the *Zone Franche* are exempted from custom duties, other import taxes, sales taxes, and the TUT. Goods and services exported from a *Zone Franche* firm are exempted from all export duties and taxes.

All benefitting companies may take on international loans and are allowed to maintain bank accounts outside the local banking system, a significant benefit in light of the restrictions forbidding Malagasy businesses from doing so. All firms are required to open a special account in FMG at one of the country's commercial banks. The law permits repatriation by foreign firms in the Zone of amounts equal to deposits made in foreign exchange (but denominated in FMG). Banks are required to maintain foreign exchange reserves at the Central Bank sufficient to guarantee that hard currency will always be available for repatriation. In fact, in a situation where capital in a firm is entirely owned by non-resident foreigners, the total amount of the initial investment and the initial working capital must be covered by the foreign exchange reserves of commercial banks.

2. Droit Commun

In areas not covered by these special incentive regimes, or where firms have not been granted the benefits of the regimes, the *droit commun* applies. This comprises the laws, decrees, and other legal instruments that constitute the overall legal and regulatory environment.

a. Land and Property Rights

One of the major shortcomings in Malagasy legislation is the inability of foreigners to own land. In legal terms, this shortcoming is the result of a *note de service* issued by the *Ministère de l'Interieur* taking functional precedence over a constitutionally guaranteed right of ownership by foreign nationals. This *note* has been buttressed by a sequence of proclamations by the Ministry of Interior and individual

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[43] Ministère de l'Industrie et de l'Artisanat. *Regime de Zone Franche*, République de Madagascar, December 1992.

public officials forbidding foreign ownership.[44] This legal anomaly deters foreign capital investment, forcing businesspeople to secure long-term leases for property underlying whatever infrastructure they wish to develop. The process of land rental by foreigners includes a requirement of authorization by the Ministry of Interior, and leases may be written for up to 50 years.

Even for Malagasy nationals, however, land titling is not an easy process. The Ministry of Interior in 1991 estimated, in light of the lack of a comprehensive land survey, that of the country's more than 58 million hectares, 2 million are held under community property ownership, 3 million are in individually titled land (including corporate ownership), and the balance of more than 53 million remains state-owned property.[45] The process through which nationals may acquire title is an egregious one, reportedly consisting of dozens of individual legal steps hampered by continual delays in processing.

b. Labor

The World Bank noted in 1991 that a number of Malagasy regulations hamper the efficient functioning of labor markets, including limitations on mobility and regulations governing the closing of businesses or the discontinuance of certain business activities.[46] Certainly, the Code and Zone legislation attempts to remedy some of these problems through language that exempts qualifying firms from meeting these requirements in the event of ceasing operations. However, no firm in the survey noted labor regulation as a burden to efficient business practice. In some cases, this was because firms employ workers on a short-term basis in order to avoid complying with labor regulations.

There are clearly documented limitations on the ability of firms to hire foreign nationals (some of which are lightened for Zone and Code firms), and it is virtually impossible for foreign nationals to obtain Malagasy citizenship. Foreigners must obtain a working permit from the Ministry of Labor if they themselves are to launch a business, or their Malagasy employers must seek authorization from the Immigration Service within the *Ministère de la Fonction Publique, du Travail et des Lois Sociales*.[47]

c. Capital

In the late 1980s, the government initiated a significant financial liberalization program after a decade of heavy state intervention. This program included the opening of the banking sector to private capital in 1988; progressive liberalization of interest rates, which since November 1990 have been fully

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[44] As recently as 1992, the Prime Minister stated, "*Ce sont les investisseurs qui m'interessent.... Cependant, qu'il n'y ait surtout pas de spéculations: Les Malgaches tiennent à leur terre*" Madagascar Tribune, 14 August 1992, p. 7, cited by Hilton Root, *Environment for Investment in Madagascar: Institutional Reform for a Market Economy*, Center for Institutional Reform and the Informal Sector, University of Maryland, February 1993, p. 17.

[45] Interviews with the Ministry of Interior, April 1991.

[46] World Bank, *Madagascar: Beyond Stabilization to Sustainable Growth*, draft, 1991.

[47] Roland Marie Rasoamanarivo, *Lois, règlements, procédures et documentation relatifs aux exportations*, Project MAELSP/USAID, p. 12.

liberalized; and a move away from direct to indirect instruments of monetary control, which has not taken place.

Despite these reforms, Madagascar's financial sector faces major difficulties. The country has one of the lowest savings rates among developing countries and its financial depth, measured by the M2/GDP ratio, is also among the lowest. The M2/GDP ratio was stagnant between 1968 and 1988, remaining below 25%.[48]

Part of the lack of financial depth can be explained by the fact that Madagascar is one of the poorest economies in the world. However, there are a number of other factors reinforcing this trend. Although nominal interest rates are determined freely by commercial banks, real interest rates for short-term deposits are often still negative.[49] The financial system is biased toward short-term financing with little medium or long-term finance available. High rates of inflation and fluctuations in the real exchange rate in the past have led to a general distrust among economic agents concerning the attractiveness of holding financial assets. As a result, savings in real assets are, for most savers, more attractive and less risky than lending to the financial sector. Furthermore, Madagascar's financial network is concentrated in the urban areas, thereby failing to capture the surplus resources of the rural sectors. The majority of the population finds it difficult to gain access to financial assets in the formal financial sector. This is due to the nature of its activities, which are mostly agricultural, and the small size of enterprises.

The financial system also does not function efficiently because of the inadequacy of the financial infrastructure needed for intermediation and provision of payments services.[50] There is a general lack of adequate financial information on lending terms and credit risks, and financial transactions are not performed in a timely and secure manner. There is lack of legal protection for lenders as well as borrowers. The legal system is perceived as outdated -- the Commercial Code dates from the colonial era. The machinery of justice is slow, ineffective, and unreliable. These inadequacies have led to a pattern of finance in which transactions are limited to short-term maturities and to borrowers who are personally known to the lender or able to provide easily attachable collateral. As a result, exporters rely heavily on self-financing from the informal sector, which places severe constraints on the scope and nature of their trade.[51]

However, with emerging liberalization of the financial sector, Madagascar should become increasingly eligible for supplier financing. Foreign banks, including offshore banks, could provide trade finance for both imports and exports. The recourse to offshore banks has already been useful for exporters operating under the Zone. In addition, preshipment finance, especially for intermediate inputs,

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[48] World Bank, *Madagascar: Financial Policies for Diversified Growth*, A World Bank Country Study, Washington: 1993, p. 18.

[49] Manfred Zeller, *International Finance And Food Security In Madagascar*, International Food Policy Research Institute (IFPRI), draft, May 1993, p. 6.

[50] Zeller, *International Finance ...*, p. 39.

[51] Zeller, *International Finance ...*, p. 7.

is likely to become more important as the world market begins to appreciate the reputation of Malagasy exporters. Presently, there is reluctance on the part of financial institutions to intervene at the preshipment stage because there is a significant element of risk that final production, and hence payment, may not materialize. Banks are worried that their funds may become tied up for too long and without any guarantee.

Enlarging preshipment finance will require increased synergy between (a) foreign manufacturers and exporters of intermediate goods and (b) exporting enterprises. Export credit guarantee schemes (ECGS) could also be an important mechanism through which exports could be promoted. Experience shows that ECGS could become important for exports after nontraditional exports attain a certain minimum level. Once Madagascar succeeds in diversifying its export market, with products sold in markets characterized by greater risk, an ECGS will become crucial. This is not yet the case.

d. Access to Foreign Exchange

The financial sector liberalization of 1988 permitted importers to request and receive any amount of foreign exchange and to seek financing through any means for imports, including their own resources, suppliers' credits, or loans from the banking system. Despite this liberalization, foreign exchange access has been limited both by the government's method of valuing the FMG and by strict regulations on who can hold foreign exchange and under what circumstances they may hold it.

An overvalued exchange rate played an important role in Madagascar's trade imbalance throughout the 1970s and early 1980s. Due to a combination of high inflation and a fixed nominal rate of 50 FMG to the French franc -- a rate that had been applied since Madagascar left the franc zone in 1973 —- the Malagasy franc appreciated in real terms by 26% between 1977 and 1982, reducing the competitiveness of Malagasy exports on the world market and making imports relatively cheap. In 1982, as part of the stabilization program, the government began a series of nominal depreciations against the French franc, although import quotas remained largely in place both before and after the devaluations took place.

In 1983-84, the focus of the reform program shifted from stabilization to structural adjustment, as the government became aware of the need for fundamental reform of price and trade policies. Decontrol of post-factory prices and profit margins and removal of export taxes on the vast majority of goods in 1984-85 was accompanied by replacement of official maximum prices for paddy by floor prices in order to promote private marketing of rice.[52] Import liberalization followed in 1987, accompanied by a major devaluation of the Malagasy franc (58% against the SDR).

The cumulative effects of exchange rate movements were mitigated by pent-up demand under price controls and trade restrictions until the late 1980s and by continued inflation through the end of the decade. The major devaluation of 1987 was followed by a managed float policy through which the government allowed the value of the FMG to float against other major currencies within some

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[52] Paul A. Dorosh, René E. Bernier, and Alexander H. Sarris, *Macroeconomic Adjustment and the Poor, The Case of Madagascar*, Cornell Food and Nutrition Policy Program Monograph 9, Ithaca, New York: December, 1990, p. 54.

predetermined range. The agreement with the IMF also called for the introduction of an open general licensing system of foreign exchange allocation through which importers could obtain foreign currency at the prevailing exchange rate and finance the purchase through a source of their own choice. The system applied only to importers of goods, not services. The OGL system remained in place until 1991, when the policy changed again in the aftermath of a run on foreign currency by importers, which drained national reserves to a few weeks' worth of imports by the end of 1990. Instead of allowing the FMG to depreciate, however, the Central Bank severely tightened credit controls and its allocation of foreign exchange.

Until recently, Malagasy exporters were required to deposit 100% of their foreign currency receipts at commercial banks, which held 60% in accounts at the Central Bank and turned in the remaining 40% to the Central Bank. The 40% portion was used for debt financing and imports by the government of energy and other commodities priced in hard currency. The 60% portion represented reserves against which importers could draw on an as-needed/as-available basis. Importers who were not exporters faced severe constraints on their ability to gain access to foreign exchange, and the rules restricting access by exporters to a maximum 60% of their receipts (and often less given the demand for foreign exchange) created an incentive for clandestine off-shore trading of FMG for hard currency.

The cost to exporters of this policy increased during the early 1990s as the FMG became increasingly overvalued due to inflation, pent up demand for imports, and other factors. In May 1994, however, the government abandoned its policy of trying to manage the exchange rate and allowed the banks to buy and sell currency at whatever exchange rate they chose. The average bank rate was published each day, and this rate was to be used for transactions smaller than 20,000 FF. As a result the rate moved relatively quickly from about 320 FMG/FF to 560 FMG/FF. At the same time, exporters were allowed to retain 10% of their foreign exchange earnings, with the goal of moving towards 100% retention as circumstances permitted. This was a first step towards implementation of *Loi No. 91-014*, passed by the Assemblée Nationale in late 1991, which was to enable exporters to retain a portion of their earnings outside of Madagascar. Final enactment of the law was contingent on a ministerial decree that was never issued.[53]

With the exception of the 10% retention, Madagascar maintains the requirement for Malagasy exporters that foreign exchange proceeds should be repatriated and surrendered in exchange for local currency. Although the cost of this policy is less than it was in the recent past, it is not zero and there is presently no adequate mechanism for exchange rate risk coverage for exporting enterprises.

It is instructive to compare this system with that which exists in Mauritius, where the government has managed its foreign exchange system quite flexibly, allowing exporters to retain foreign exchange balances in diverse currencies with domestic commercial banks so as to meet their foreign exchange commitments on imports.[54] This system has helped the enterprises to offer coverage against exchange

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[53] Cabinet de Conseille d'Entreprises, *Projet de Promotion des Exportations Agricoles, Rapport sur l'Aspect Juridique et Réglementaire*, draft, February 1993.

[54] World Bank, *Financial Policies...*, p. 197.

rate fluctuations. In addition, it has enabled them to generate income from foreign exchange management.

e. Import Taxes and Procedures

In the 1970s, the Malagasy government strengthened import prohibitions and quantitative restrictions. By 1986, quantitative restrictions applied to all imports, and imports of goods produced in Madagascar were totally prohibited. The tariff structure was quite complex and discriminatory. There were 60 different tariff schedules ranging from 0% to more than 1000%, resulting in high effective protection for some sectors and products.[55]

In 1987, the government initiated the liberalization of the import sector. All non-tariff barriers to imports were eliminated and a 30% surcharge was introduced on some previously prohibited imports in order to ease adjustment in the sectors concerned, primarily textiles and meat. This surcharge was reduced to 10% in 1989 and was eliminated in 1990. Tariff variance was reduced by lowering the number of rates from 69 in 1987 to 14 in 1990, and by limiting the rates to multiples of five between a minimum of 10% and a maximum of 80%.[56] This marks a substantial improvement over the prior byzantine system of import bans and taxes, but the system still remains complex and expensive with respect both to taxes and procedures.

i. Import Taxes

The *Loi de Finance* for 1992, the year to which the survey in Madagascar applies, provides details of tax rates applicable to every type of imported good. Four separate taxes rates were involved, including the *droits de douanes* (DD), the *taxe d'importation* (TI), the *taxe de consommation* (TC), and the *taxe unique sur les transactions* (TUT). Each of these applied to the CIF value of imports, except the TUT, which applied to the CIF value plus the sum of the other three taxes paid. The list of goods was exhaustive, requiring 319 pages of the *Journel Officiel*, and rates varied markedly according to product and purpose. For example, the TI alone was 50% for mineral water, 45% for cut flowers and edible nuts, 40% for various spices, 35% for crustaceans and other types of seafood, 10% for chemicals and chemical derivatives, 30% for plastics and polymers in various forms, 15% for skins and leathers, and 25% for finished clothing.

While there appeared to be a certain pattern of higher rates for goods that are produced or producible in Madagascar than for goods that must by imported, this characterization was not uniform, nor was there any evidence of generally higher rates for finished goods versus intermediate inputs or for luxury goods versus necessities: eyeglasses incurred a TI of 40% while golf clubs were taxable at 25%. As an example of the byzantine nature of the import tariff schedule, the law stipulated that imports of canvas pieces for shoe manufacture were subject to a DD of 35%, a TI of 5%, and a TUT of 5% (they

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[55] World Bank, *Madagascar: Financial Policies ...*, p. 19.

[56] Rasoamanarivo, *Lois, Règlements...*, p. 16.

are exempt from the TC), but sheets of canvas weighing 400 grams or more per square meter were subject to 0% DD, 40% TI, 5% TC and 15% TUT.[57]

Taken together, some intermediate inputs could become prohibitively expensive when all of the various duties were added together. Table IV-4 demonstrates that the total tax burden on imports of cotton fabric amounted to 70%, the same rate as for finished clothing. In fact, a typical Malagasy manufacturer of clothing competing with *Zone Franche* industries in the same sector would have needed to pay duties at an unweighted average of 45% for the basic inputs outlined in Table IV-4.

TABLE IV-4
TAX RATES FOR IMPORTED INPUTS USED IN THE GARMENT INDUSTRY (%CIF)

	DD	TI	TC	TUT	Total
Cotton material	35	15	5	15	70
Thread	ex	20	ex	15	35
Sewing machines	5	15	ex	15	35
Needles	5	15	ex	15	35
Washing machines	10	30	ex	15	55
Paper and cartons for packing	5	15	5	15	40

Notes: DD droits des douanes, TI taxe d'importation, TC taxe de consommation, TUT tax unique sur les transactions

Source: *Journal Officiel, Loi de Finances, Tarif des droits et taxes perçues par la douane*, July 27, 1992.

In recognition of the complexity of this system, a number of significant modifications are in the process of being made. First, the TUT, which has alternated between being a value added tax and a turnover tax, has been combined with the *taxe de consommation* and became a straightforward turnover tax called the *taxe sur les transactions* (TST). This tax is scheduled to become a value added tax (VAT) in the near future. Second, a subsequent *loi de finance* was issued in late 1992 that greatly simplified the import tax structure. This law established the following rates for the combined DD and TI: raw materials 10%, intermediate products and basic final products 20%, ordinary final products 30%, semi-luxury final products 40%, and luxury final products 50%. The top three rates are to be collapsed into a single 30% rate by a *loi de finance* to be voted on in 1994.

Despite these reforms, the rate of taxation on many imported inputs can be quite high. For example, most of the inputs into the garment industry are taxed at a combined DD/TI rate of 30% because these can be considered as basic finished products as well as intermediate inputs. Adding the basic VAT (now TST) of 25% times the CIF value plus import duties, one arrives at total tax on these imports of 62.5%. This high rate of duty on imported inputs used in the production of exports makes it imperative that a viable system for duty-free admission of these imports be put in place.

[57] GDRM, *Journal Officiel, Loi de Finances*, July 27, 1992, p. 1322.

ii. Duty-Free Admission of Imported Inputs

Several mechanisms already exist for the duty-free admission of imported inputs, as well as for other tax exemptions on the inputs used in producing exports. Each of these has its disadvantages.

Zone Franche

The tax exemptions of the *Zone Franche* are the most comprehensive and easily implemented. Since the Zone does not comprise a specific geographical area, however, problems of monitoring and enforcement arise, especially for smaller firms to which a customs agent cannot be permanently assigned. Furthermore, although Zone status is open to all firms that export close to 100% of their production, in practice only those that are of a certain size apply and are approved. In addition, the benefits are not available to firms that produce partly for the domestic and partly for the export market. Thus Zone status tends to be highly discriminatory.

TUT Exemption and Temporary Admission

Firms that export more than 75% of their total production are eligible to be exempted from the TUT paid on locally purchased imports. This requires approval by the Directeur des Impôts each time that these purchases are made. All firms are eligible for temporary admission, without payment of import duties, TUT, etc., of imported inputs used in the production of exports (*régime suspensif des droits)*. This procedure is used mostly by the larger exporters. It poses significant problems of monitoring and control. All of these procedures are subject to abuse in the form of tax evasion, discretionary approvals open to corruption, lack of widespread publicity, and time-consuming steps required for approval.

iii. Import Procedures

The procedures governing imports also increase transactions costs. These procedures require that goods are met by a personal representative of the importing company at the point of disembarkation. Customs clearance is reportedly often a matter of negotiation rather than standard procedure; it requires a myriad of certifications, goods identification, and securitization of property. The procedures have proven to be so onerous that the government agreed after a year of negotiation with importers to pass along a large portion of the work of customs clearance for imports to a private firm, Veritas, which certifies that actual shipments conform to invoices and import documents.

A large part of the problem in streamlining import procedures is the discretionary authority of customs officials in delaying delivery of goods for purposes of verification and payment of appropriate duties. While the Veritas system has aided in avoiding fraud in the form of under- and over-invoicing, the system remains hostage to a large number of regulations that must be enforced by a small number of customs agents. These agents have the power to disrupt the flow of goods and physically open containers for verification of contents at any stage of the process of importation. While import and customs taxes are not paid directly to agents, but rather to banks which then provide written confirmation that must be furnished to customs, agents do have an incentive to delay clearance and could potentially profit personally from cash bribes and other *cadeaux* to speed the process. However, there is no evidence that this type of activity constitutes a major cost to importers. While several exporters reported

paying tips of one kind or another to customs agents, the amounts were paltry and paled in comparison with the cost of delays in delivery of key inputs.

The delays in obtaining clearance of imports range from a few days to many months, according to the firms surveyed. Inclusion in the *Zone Franche* (ZF) does not insulate firms from this type of delay. One firm reported that every shipment of imported inputs requires detailed chronicling of quantity and price, and proof of exemption of these imports from import tax. This firm reported that delays in confirming this information and processing forms took an average of two weeks per shipment between the arrival of the goods in Madagascar and clearance for delivery to the firm. Delays for firms that are not classified under the ZF were far longer, in some cases stretching up to several months. Filing the paperwork alone would sometimes require several days.

Part of the problem has been due to the range of tax rates mentioned above. However, even simplification of the tariff structure will not solve the problem cited as most important among the factors constraining the customs service from efficient operation: lack of personnel. The *Direction des Douanes* reportedly employs 750 customs agents to administer all of the traffic across borders, including people and goods. There are insufficient personnel even to monitor the industries within the *Zone Franche* to ensure that imported intermediate inputs exonerated from import tax are actually reexported. The solution probably lies both in simplifying export and import procedures and reducing the number of approvals required and in increasing the resources and efficiency of the customs service.

f. Export Taxes and Procedures

i. Export Taxes

Formal export taxes were practically eliminated in September 1988 (*décret* no. 88-015 01.01.1988). Although legal irregularities remain with respect to the procedural elimination of export taxes, as well as many of the regulations governing exports,[58] only vanilla remains subject to an export tax.

ii. Export Procedures

The 1988 *décret* also simplified many of the procedures faced by exporters. The law eliminated the requirement of an export card, as well as quality checks for all exports except of meat and seafood.

However, legal simplification of export procedures has not led to practical simplification. The *décret* was not successful in relieving exporters of requirements that can be numerous and cumbersome depending on the nature of the product to be exported. While the legal underpinnings of these requirements may be suspect, since the 1988 law formally abrogates all pre-existing regulations at the same time as it leaves some discretion to individual ministries, the practice of customs agents requiring approval for exports by one or more ministries is reportedly common.

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[58] Christopher L. Shaw, J. Dirck Stryker, and Louis Aucoin, "Costs and Benefits of Removing Institutional Constraints on Nontraditional Exports: Madagascar Case Study, Associates for International Resources and Development, June 1994, Annex A.

Every exporter is required to obtain a *Domiciliation Déclaration Exportation et Engagement de Répatriation de Devises* from his commercial bank, at a cost of up to FMG 5000. Generally exporters reported that banks furnished this documentation in a half-day or less. Completion of the *Déclaration des Douanes (Serie E)* is also required of all exporters, and this procedure requires more time since the form asks for detailed descriptions of what is being shipped. Phytosanitary inspection and approval by the Ministry of Agriculture is required for exports of meats and fish, and safety inspections of agricultural produce is legally optional but sought by exporters who wish to reassure their clients of quality control. Other optional clearances include certificates of origin issued by the Chamber of Commerce, certificates of quality control in packing, certificates of merchandise traffic for goods headed to the European Community (issued by banks and used by only a few exporters), and exit authorization by the Ministry of Commerce (used by almost no one in the survey).

Other requirements apply on a product-by-product basis, and their application is rife with irregularity and subject to the discretion of ministry and customs authorities.[59] For example, export of any artifact or handicraft that might hold cultural significance requires inspection and approval by the *Ministère de l'Industrie, Energie et Mines*, which also must approve any export of mined material, whether stone, gems, or minerals. Export of any wood product requires clearance by the *Direction des Eaux et Forêts* in the *Ministère de la Production des Animaux, des Eaux et Forêts*. Export of a wooden artifact, therefore, would require clearance by both ministries.

Delays vary widely from case to case. Some exporters report that their forms are processed quickly, within one day per ministry, while others experience delays ranging from two to ten weeks. Several business people complained of the lack of certainty surrounding export procedures, that some people appeared to receive unwarranted exoneration or special service as a result of personal relationships (not bribes, interestingly), that rules were in a constant state of flux, and that enforcement by customs agents was haphazard.

The actual cost of these delays is unclear since several exporters noted that export procedures in general were cumbersome but that costs incurred due to paperwork were minimal compared to customs delays and costs associated with limited shipping and storage capacity (see below).

3. The Judicial System

None of the firms surveyed mentioned the lack of an indigenous legal system of dispute resolution as a major constraint to the growth of trade. However, several recent reports have documented the inadequacies of the Malagasy judicial system with respect to commercial law, dispute resolution, competition law, and judicial independence.[60] Taken together, these reports paint a picture

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[59] It is not clear whether the Ministries in these cases are implementing a unilateral *note de service* or are operating on the basis of practice dating to before the 1988 *décret*. What is clear is that application of these procedures is clearly in conflict with the spirit and the letter of the 1988 legal reform, and clarification of these and other legal inconsistencies is fundamental to reducing the uncertainty faced by exporters.

[60] They include Louis Massicotte, *Towards an Independent and Accountable Judiciary: Report on Judicial Reform in Madagascar*, Center for Institutional Reform and the Informal Sector (IRIS), University of Maryland at College Park, September 1993; Root, *Environment for Investment...*; Louis Aucoin, *Dispute Resolution as an*

of the Malagasy legal and judicial system as so entangled in inconsistencies, ill-developed jurisprudence, and misplaced discretionary authority that it renders the system "ineffectual and unreliable."[61] Malagasy entrepreneurs and foreign investors are advised to stipulate in their contracts recourse to international arbitration rather than the Malagasy court system so as to ensure efficient and equitable resolution of conflict. Where parties must turn to the Malagasy courts to adjudicate disputes, the costs in time and wasted resources could well be considerable, even if the final outcome is satisfactory from a legal standpoint, a result that is far from guaranteed.

4. Other Constraints

Exporters in Madagascar must contend with other constraints, some of which are already well documented in the literature.[62] Decrepit transportation and telecommunications infrastructure, insufficient storage facilities, a monopoly on air cargo, a shortage of qualified labor, and lack of information on external markets are among the most egregious of these constraints. Each has some aspects falling under the institutional rubric.

a. Transport and Telecommunications

The road network in Madagascar remains in a deplorable state despite recent improvement in the primary road network, especially the major road link between the capital city and the port of Tamatave, the paving of which was recently completed. Some primary roads linking provincial capitals, most secondary roads, and virtually all access roads are impassable for many months of the year, severely limiting transport of goods to major points of departure.

The seaport capacity of Madagascar is also strained. While ocean transit is the transport of choice for most of Madagascar's exports, the two ports at Mahajanga and Toamasina are operating at their theoretical capacity and by 1995 will face a capacity constraint.[63] Projections for the smaller eastern and southeastern ports are more hopeful, but the costs of exporting are driven up in these cases by the need for lighterage, i.e. transferring goods from a quay to a smaller vessel, which then transfers the cargo to oceanliners waiting in deeper water. Lighterage costs are particularly high in the eastern ports because of exposure to heavy seas on the Indian Ocean side of the island; only the major eastern port at Toamasina offers adequate protection from weather. Also, the vast majority of cargo in Madagascar is transferred from truck or train to ship manually. When implemented, plans for port rehabilitation are likely to mitigate these high costs.

Alternative to the Ordinary Courts in Madagascar: A Guide to Choice in the International Arena, IRIS, October, 1993.

[61] Aucoin, *Dispute Resolution*, p. 1.

[62] J. Dirck Stryker, Jeffrey C. Metzel, Ashley S. Timmer, *Regional Specialization and Agricultural Growth in Madagascar*, AIRD, Cambridge, Massachusetts, January 1993.

[63] Stryker, Metzel, and Timmer, *Regional Specialization ....*

Among the most serious infrastructural shortcomings for exporters, especially since a majority of exporting companies are located in the capital region, is the lack of a freight terminal in Antananarivo. Many of the exporters interviewed remarked on the need for a terminal in the capital to provide a central location for storage and transfer of cargo among rail, truck, and air carriers; to act as a point of contact for consolidating shipments; and to serve as a collection point for available containers, of which there is a constant shortage. Smaller Malagasy exporters also lack cold storage at the airport, a fundamental component of successful trade in fresh produce, seafood, and meat.

The transport system in Madagascar suffers from inefficiencies created by the state monopoly over air cargo imposed by the government-owned airline, Air Madagascar. This monopoly results in prohibitively high air freight rates for exporters, who cannot afford to take advantage of the space that exists on Air Madagascar's (and Air France's) backhaul to Nairobi, South Africa, Reunion, and Europe. Many firms in the survey complained of high rates, unused space, and missed opportunities for markets abroad brought on by Air Madagascar's chokehold on the air freight market. Reports confirm this phenomenon, insofar as there is excess capacity on flights leaving Madagascar in all but the most intensive months of the litchi season.[64] While air cargo prices appear to be competitive on runs to and from Reunion, Air Madagascar rates to European destinations are 20 to 30% higher than rates for comparable runs from Nairobi on private carriers, though private carriers operating the Kenya-Europe route can charge somewhat less for reasons both of distance and of high back-haul capacity on a large number of commercial flights. Should the rates from Madagascar be lowered to more competitive levels, there would be a substantial increase in demand, which would soon require the use of cargo planes.

Sea shipping rates are higher from Madagascar to Europe than from Mauritius to Europe for reasons unrelated to restricted capacity or oligopoly.[65] While rates are roughly 30% higher for higher value products (such as sweaters) leaving Toamasina compared with St. Louis -- 1300 ECU per container from the Malagasy port compared with 1000 ECU from the Mauritian port -- the two ports operate at similar levels of efficiency. Although there are some pricing distortions due to historical pricing patterns and the nature of the public/private interface in freight management in Madagascar, the differential is due largely to structural and navigational problems in the Toamasina port which require capital investment for improvement. The Société Nationale Malgache de Transport Maritimes (SMTM) considers that shipping rates are quite competitive with the world market now and cannot be lowered much further, a claim that is supported by private shipping concerns such as the Mediterranean Shipping Company.[66] Therefore, the higher costs of shipping by sea should be considered a real cost of operating in Madagascar.

Telecommunications within Madagascar are very poor. Firms have great difficulty calling or faxing the airport or one of the ports from their farms, factories, or head offices. They frequently have

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[64] Charles Steedman, *Do Telecommunications and Air/Sea Transport Problems Limit Madagascar's Exports?* Center for Research on Economic Development, University of Michigan, January 1993.

[65] Ibid, pp. 22 *et seq.*

[66] Ibid, p. 23.

to resort to sending messengers, which is costly, time-consuming, and contributes to traffic congestion. This impedes efficiency and makes timeliness and quality control difficult.

b. Labor

Several exporters remarked on the lack of skilled labor in Madagascar. With better than average levels of educational attainment and high unemployment, Malagasy workers work hard, work productively, and work long hours. Nevertheless, despite broad satisfaction with the general quality of labor, several exporters reported having trouble finding workers with the requisite skills and were forced to incur the costs of supplemental training. Several companies in the *Zone Franche* actually set up quite extensive training units to transfer specialized skills to their workers.

c. Market Information

Finally, Malagasy exporters face significant competition in international markets, especially with respect to high value products destined for Europe, Asia, and North America. Information on these markets and on the nature of the competition is poor, and connections to overseas distributors and potential foreign partners require substantial investments of time and capital. Despite the comparative advantage that Madagascar holds for supplying regional markets in southern Africa, especially in the wake of the democratization of South Africa, most of the economic activity within the private sector remains domestically oriented or oriented towards Europe.[67]

C. Survey of Nontraditional Exporters

Analysis of the survey of nontraditional exporters included two major steps. The first step, reported here, involved the identification of a number of key variables and the estimation of a series of regressions to reveal which variables are the most important in determining whether, and to what extent, institutional constraints are experienced by firms. The second step, reported in the next section, consisted of the calculation of a number of indicators of comparative costs and incentives, with and without accounting for the costs of institutional constraints.

1. Characteristics of the Sample

a. Quantitative Description

The sample includes 34 firms, all of which export goods from Madagascar. The sample represents a variety of sectors, and includes firms exporting to a range of markets. Sectors represented include agricultural products (26% of the sample); garments and textiles (18%); marine products, processed foods, and miscellaneous manufactures (12% each); wood products (9%); and handmade artisanal goods and semi-precious stones (6% each). Thirty-nine percent of the sample exports 100% of production, and the rest export from 10% to 80% of production. Overall, exports average 59% of total sales. The percentage of firms exporting to each market is as follows: Europe in general (41%), the

[67] J.E. Austin Associates and Management Systems International, *MAPS Private Sector Survey: Madagascar*, prepared for USAID Madagascar, April 1991.

Indian Ocean (38%), France (35%), US (21%), Asia and Germany (15% each), other points in Europe (9%), Africa (6%—mostly South Africa), and the United Kingdom (3%). Many firms export to more than one region or country.

Firms vary greatly in size. Of the firms reporting total sales, 10% (3 firms) gross FMG 100 million or less in total annual sales (about $55,000 at the official exchange rate prevailing at the time), and 6% report sales falling between FMg 20 and 30 billion ($11 to 17 million). More than two-thirds of the sample (68%) falls in the 1 to 10 billion FMG range ($0.5 to $5 million).

As for the age of the firm, one-third of the sample registered officially with the *Registre de Commerce* during or before 1980, whereas 24% registered in 1990 or later. Capacity utilization was high, with 58% of the respondents to this question reporting 90% or higher utilization.

Over one-third of the sample (12 out of 31 firms) consists of labor-intensive enterprises, employing more than 100 workers per billion FMG in sales, while almost half (14 firms) employ fewer than 50 workers per billion FMG in sales. Interestingly, the garment industry, which is thought to be quite labor-intensive, covers a range from 15 to 258 workers per billion FMG in sales, though all of the garment/textile firms employ a considerable number of workers and together account for more than half of all firms employing 300 or more workers. All garment firms are either classified as *Zone Franche* enterprises or have access to duty and tax-free inputs under the TUT exemption and temporary admission procedures.

There is a negative correlation between exporters that are labor-intensive and those that are intensive in the use of natural resources or capital. One of the working hypotheses is that Zone firms, which often are established with substantial foreign capital, gain their competitive edge from low-cost labor and almost total reliance on imported inputs for raw materials and intermediate products. Those firms that are not in the Zone, on the other hand, are more likely to be of two types. The first is highly export oriented, but relies more on the natural resource base of Madagascar than on its pool of low cost labor. The second type of firm outside the Zone was established some time ago to produce for the domestic market and has only more recently begun to export. Often these firms were established behind protective trade barriers, so that they tend to be more capital-intensive and to have less of a comparative advantage in exports unless they have already made a successful transition away from their orientation towards the domestic market.

The survey reveals the following constraints facing exporters with respect to imported inputs (in the order of the frequency of their citation by firms):

i. import procedures (14 firms cited this as a problem)
ii. access to foreign exchange (13)
iii. transport capacity for imports (4)
iv. access to import financing (2).

The major constraints facing exporters with respect to production and exporting finished goods include:

i. export procedures (16)
ii. access to capital for fixed investment (11)
iii. constraints on physical capacity and/or cost of transport off island (10)
iv. lack of working capital (6)
v. inadequate skill levels of labor (5)
vi. transportation infrastructure (5)
vii. inadequate product quality (2).

It is noteworthy that no firm mentioned lack of markets overseas as a constraint on exports, and virtually every firm noted some form of foreign cooperation in the promotion of exports.

The rules governing Zone and Code firms, as opposed to Malagasy firms that do not qualify under either regime, appear to make a significant difference in the propensity of firms to experience institutional constraints to trade. This was borne out in subsequent analysis of the survey data.

b. Qualitative Analysis

The results of the survey cannot be described just in quantitative terms. Much of the information that was gathered from the exporters is better expressed qualitatively. In doing so, it is useful to make a distinction between the real cost of doing business in Madagascar's export trade and those costs that are amenable to policy change.

i. Real Costs

The surveys indicate that the real costs are formidable and derive from inadequacies in the domestic transportation and telecommunications infrastructure, lack of depth in the financial sector, and shortcomings of the judicial system. While these constraints can be altered over time, the process is likely to be a slow one and will require considerable investment.

Infrastructure

Infrastructural inadequacies were often cited in the survey as a sources of major costs and delays. Five firms mentioned transportation infrastructure explicitly as a major constraint to exports. For firms that collect products such as dried beans from the countryside, delays resulting from poor transportation mean the loss of a substantial competitive edge in overseas markets. Many firms related anecdotes during personal interviews that underscored the inefficiency inherent, for example, in relying on personal messengers for communication between the port of Tamatave and the capital city.

Financial sector

The lack of depth in the financial sector affects exporters with respect to both working capital and capital for fixed investment. Banks report broad use of letters of credit by exporting firms, an assertion borne out by the firms themselves. Smaller firms, however, are not always able to obtain LCs, or the cost may be too high in relation to the value of shipment. In other instances, goods are shipped

on consignment, where LCs are not appropriate. Other forms of financing, including pre and post-shipment, are relatively rare. Businesses who have access to other forms of credit are generally limited to those with personal contacts or accounts abroad.

Lack of working capital was considered less of a constraint on exports than lack of capital for fixed investment. The high rate of capacity utilization and the expressed desire of many firms to expand is evidence of the lack of access by private firms to capital. The existing capital market does not allocate resources according to greatest need. Instead, ceilings imposed by the Central Bank on credit to the major commercial banks and lack of financial intermediation have forced private sector cooperatives and associations to create their own credit and financing mechanisms. These include FIVCAM, put in place by the business association FIVMPAMA (a Malagasy acronym for *Groupement des Opérateurs Privés Nationaux),* to which many of the exporters of nontraditional products belong; SIPEM created by GEM (*Groupement des Enterprises de Madagascar)*, another business association counting among its members many of Madagascar's traditional exporters; FIARO, a capital risk and capital development fund; MADINVEST; and Entreprendre à Madagascar.[68] These organizations suffer from lack of resources, however, since they are dependent on members' contributions for their capital.

Judicial system

There is little evidence that firms employ the Malagasy court system to resolve commercial disputes. In those cases where Malagasy firms did report having suffered some form of injustice, whether imposed by a contracting party or by public authority, these grievances appear to have gone largely unheard in any forum. There is thus a disincentive to enter into any sort of business relationship in which the entrepreneur cannot bear the risk of large losses of orders or inventory. This is a real cost of doing business within the Malagasy economy, and can only be reduced through continued legal and judicial reform.

ii. Costs Amenable to Policy Change

Respondents identified a number of costs that accrue to exporters that should be amenable to policy change. These included unnecessary fees and tips, lack of free access to foreign exchange, delays in obtaining clearance for entry of imported inputs or exit of finished goods, and high cost of transport for both imports and exports.

Fees and Tips

Fees include the *taxe professionelle* and the *patente d'exportateur*, paid annually; payments to a private forwarding agent (*transitaire*), usually equal to about 0.5% of the value of the imported or exported material; bank and customs fees; fees for certificates of origin, certificates of quality control in packing, certificates for goods destined for the European Union,and exit authorizations by the Ministry of Commerce; and fees charged for clearances by specific ministries. Not all of these fees are mandatory, and there is broad variation among individual firms as to the amounts paid and the extent to

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[68] République de Madagascar, Groupe de Travail Technique, *Intégration Economique Régionale, Projet de Rapport Final*, November 10, 1992.

which these fees represent onerous costs to the firms. Among non-Code, non-Zone firms, these fees ranged from 0.04% of total sales FOB to about 1%. As a group, however, fees for non-Code, non-Zone firms represented a higher percentage of sales than did fees for firms under one of the incentive regimes. Since only Zone firms are formally exonerated from liability for the *taxe professionnelle*, Code firms also paid out considerable fees, ranging from 0.1% to about 1%. Across the board, tips and other *gratuités* constituted a nearly negligible proportion of the total fees paid, falling in the range of FMG 10,000 to 50,000 per shipment.

Access to Foreign Exchange

Lack of access to foreign exchange was a frequently cited problem in the survey. Malagasy law prevents any national from holding a foreign exchange account at home or abroad.[69] As a result, exporters are required to convert their foreign exchange into FMG at whatever rate they can get from their banks. During the period of the survey, this rate was fixed by the central bank at a level that tended to increasingly overvalue the FMG, thus penalizing exporters. As a result, there was an incentive to underinvoice exports and to exchange foreign currency for FMG either offshore or on the local black market at a more favorable rate of exchange.

Customs and Shipping Delays

Costs associated with export delays varied widely according to the experiences of individual firms. Such costs include the costs of delays from customs clearance, as well as the delays associated with shipping. While some firms did not report bearing any additional costs associated with customs or shipping delays, others cited these as amounting to FMG 15 to 20 million ($8000 to $12,000), primarily from spoilage and lost or cancelled orders, although the capital costs associated with delays could also be important. For several firms both in and outside the *Code des Investissements*, these costs amounted to 15 to 25% of total FOB sales.

Air and Sea Freight Charges

Some of the air and sea freight charges reported in the survey are presented in Table IV-5. This table shows the much higher cost of air as compared with sea freight. It also shows that savings can be achieved on air freight charges by shipping in volume. Furthermore, if air freight costs could be reduced by 20 percent by eliminating the existing monopoly of Air Madagascar/Air France, this would represent savings of about 2.4 FF/kg, or 3% of a product worth 80 FF/kg FOB. This is a considerable saving in a competitive export market.

[69]This was changed in May 1994 to allow exporters to retain 10% of their earnings of foreign exchange.

TABLE IV-5
AIR AND SEA FREIGHT RATES 1992

Industry	Destination	Price as Reported	Units	Qualifier	Standardized Price
Air Freight Rates					
Processed foods	France	12.25	FF/kg	min. 45 kg	3835 FMG/kg
Process foods	France	10-14	FF/kg		3757 FMG/kg
Agriculture-livestock	France	10.7	FF/kg		3350 FMG/kg
Plants	France	3310	FMG/kg	>300kg	3310 FMG/kg
Marine products	France	3880	FMG/kg		3880 FMG/kg
Marine products	France	3770	FMG/kg	>500kg	3770 FMG/kg
Agriculture	Europe	3770	FMG/kg	>500kg	3770 FMG/kg
Processed foods	Reunion	2035	FMG/kg	min 45 kg	2035 FMG/kg
Agriculture-livestock	Reunion	6	FF/kg		1878 FMG/kg
Agriculture	Reunion	2034	FMG/kg		2034 FMG/kg
Agriculture	Mauritius	3195	FMG/kg		3195 FMG/kg
Sea Freight Rates					
Agriculture	Europe	1000-1200	$/container		6325 FF/container
Agriculture	Europe	1000	$/container		5750 FF/container
Agriculture-livestock	Europe	3300	ECU/refrig container		16500 FF/refg cont
Agriculture	Reunion	1500000	FMG/container		4477 FF/container
Wood	Reunion	4500	FF/container		4500 FF/container
Wood	Japan	12000	FF/container		12000 FF/container
Agriculture	Asia	1500	$/container		8625 FF/container

Exchange rates: 1800 FMG/US$, 5.75 FF/US$, and 1.15 ECU/dollar.
Source: Survey results; for ECU and FF exchange rates, *Wall Street Journal.*

Customs clearance

The financial burden of air freight premiums appears to be less than the burden due to delays in customs clearance, particularly for those companies exporting perishable items such as meats, fish, and other consumables. One company that exports high value perishable products to France reported that export delays could cost up to FMG 15 to 20 million per year, or about 15% of its value of total sales FOB. The costs of delays reported by other companies was in a similar range -- 3% to 10% of total sales. Another complaint voiced by even the *Zone Franche* firms is the lack of agents available for on-site customs clearance prior to packaging for shipment.

Part of the problem in customs clearance of food products is due to the nature of the product: while it is necessary to move the goods quickly, it is also essential to meet sanitary standards in order to protect not only the particular customer involved but also the international reputation of Malagasy exports. It is in these cases that the shortage of customs personnel and the need to prioritize shipments for their attention is most acute.

c. Prioritization of Institutional Constraints

The analysis of the survey results permits the a rough prioritization of institutional constraints according to their relative cost to firms. Table IV-6 presents a ranking of institutional constraints, an estimate of their costs expressed as a percentage of total FOB sales, the type of firms that must incur these costs, and comments.

TABLE IV-6
RANKING OF INSTITUTIONAL CONSTRAINTS

Rank	Institutional cost	% of sales FOB	Type of firm affected	Comments
1.	Foreign exchange access	3 to 10%	All firms outside the Zone	Cost dependent on extent of overvaluation and ownership.
2.	Customs clearance	0 to 25%	All firms	Affects Zone firms much less than other firms. Applies to both imports and exports, although delays to exports clearance related to lack of infrastructure as well.
3.	Air freight monopoly	0 to 8%	Perishable product firms	Limited to those firms able to use air freight.
4.	Fees	up to 1%	Non-Zone	Variable and dependent especially on ministerial clearances required.
5.	Tips	Negligible	All firms	

Note: Real costs of poor infrastructure, capital constraints, and unreliable judiciary not included

It should be noted that for those firms not included in the Zone or Code, import taxes would theoretically rank high on this list, depending on the reliance of a firm on imported inputs and the rate at which these inputs are taxed. Table IV-3 provides examples of total effective tax rates on inputs into the garment industry and shows that the burden for firms that are obliged to pay these taxes can be considerable.

2. Regression analysis

Regression analyses were run in order to discern the combined effects of different variables included in the questionnaire.

Industry type

Exports were run against a total of ten dummy variables indicating industry type. The only significant result occurred in the case of the garment and textile industry, as shown in the following.

$$LEXP = \underset{\substack{(0.34)\\ t=17.58}}{6.05} + \underset{\substack{(0.77)\\ t=2.27}}{1.75}DIND8 \qquad Adjusted\ R^2 = 0.13,\ df = 28$$

where LEXP = natural log of total exports in millions of FMg;
DIND8 = 1 for garment or textile industry, 0 for other.

When the natural log of sales was introduced as an independent variable into this equation, however, the industry dummy variable was no longer significant. This is reasonable since most of the garment and textile firms are either in the *Zone Franche*, where most firms export 100% of their output, or they are owned by foreigners who have the export market primarily in mind. This becomes evident by looking at the following regression results.

$$DIND8 = \underset{\substack{(0.14)\\ t=3.46}}{0.48} - \underset{\substack{(0.15)\\ t=-3.20}}{0.47}OWN1 + \underset{\substack{(0.15)\\ t=1.96}}{0.30}LEG2 \qquad Adjusted\ R^2 = 0.43,\ df = 25$$

where OWN1 = 1 for wholly Malagasy owned, 0 for other;
LEG2 = 1 for *Zone Franche* firm, 0 for other.

These results show that garment and textile firms tend to be foreign owned, included within the Zone, or both.

Ownership status

A two-parameter log function testing the impact of ownership status on exports revealed that wholly Malagasy ownership (as opposed to foreign-ownership and joint ventures) was significantly negative as a predictor of exports, suggesting that Malagasy businesses operate at a disadvantage compared with other firms.

$$LEXP = \underset{\substack{(0.55)\\ t=13.47}}{7.46} - \underset{\substack{(0.67)\\ t=2.11}}{1.41}OWN1 \qquad Adjusted\ R^2 = 0.11,\ df = 27$$

This is true even if we correct for size by introducing sales into the equation.

$$LEXP = \underset{\substack{(1.52)\\ t=2.46}}{3.73} - \underset{\substack{(0.18)\\ t=-1.19}}{1.17}OWN1 + \underset{\substack{(0.18)\\ t=2.61}}{0.47}LSALES \qquad Adjusted\ R^2 = 0.27,\ df = 28$$

Legal status

As expected, legal status had a significant impact on the degree to which export procedures posed a constraint to trade. Those firms that do not benefit from the Code or the Zone are significantly more likely to report problems with exports:

$$XPRO1 = \underset{\substack{(0.06)\\ t=1.15}}{0.07} + \underset{\substack{(0.14)\\ t=2.50}}{0.35LEG4} \qquad \text{Adjusted } R^2 = 0.14, \quad df = 32$$

where XPRO1 = 1 for firms citing export procedures as constraint to trade, 0 for other
LEG4 = 1 for firms that are neither Code nor Zone, 0 for other.

This was a considerably better predictor than Zone status alone, which yielded the following.

$$XPRO1 = \underset{\substack{(0.11)\\ t=5.73}}{0.62} - \underset{\substack{(0.22)\\ t=-1.54}}{0.33LEG2} \qquad \text{Adjusted } R^2 = 0.05, \quad df = 27$$

However, holding sales constant, firms in the Zone had significantly greater exports than firms that were not in the Zone.

$$LEXP = \underset{\substack{(1.06)\\ t=1.39}}{1.48} + \underset{\substack{(0.14)\\ t=4.46}}{0.63LSALES} + \underset{\substack{(0.53)\\ t=2.18}}{1.15LEG2} \qquad \text{Adjusted } R^2 = 0.50, \quad df = 26$$

Labor Intensity

Tests were also conducted to see if exports were associated with the labor intensity of productive activities. This hypothesis was confirmed, even with sales held constant.

$$LEXP = \underset{\substack{(1.35)\\ t=1.32}}{1.77} + \underset{\substack{(0.20)\\ t=3.87}}{0.78LSALES} + \underset{\substack{(0.20)\\ t=1.97}}{0.39LEMPS} \qquad \text{Adjusted } R^2 = 0.32, \quad df = 26$$

However, neither Zone status nor ownership status was significantly related to degree of labor intensity.

Summary

These results indicate that:

a. garment/textile industries export more than other industries;

b. garment/textile industries tend to be foreign owned and to be included within the Zone;

c. firms that are 100% Malagasy owned export less than those that are foreign owned or joint ventures;

d firms that have neither Code nor Zone status experience more problems with export procedures than those that are included in at least one of these categories;

e. *Zone Franche* enterprises export more than enterprises in any other category, even if sales are held constant;

f. holding sales constant, firms that are more labor-intensive tend to export more. Many of these firms are in the garment and textile industry.

Thus we gain a picture of a dichotomy between foreign-owned firms, many of which have Code and/or Zone status, are strongly oriented towards exports, and suffer relatively few procedural problems, on one hand, and Malagasy-owned firms, with less access to the Code and/or Zone, with less of an orientation towards exports, and with more procedural problems in exporting, on the other hand. Although this distinction is not perfect, it nonetheless exists in the sample and should be a cause of some concern for policy-makers.

D. Comparative Cost and Incentive Analysis

1. Methodological Approach

Measures of comparative costs and incentives were calculated for each enterprise using a variation of AIRD's IMPACT template to measure nominal rates of protection for both outputs and inputs, effective rates of protection, effective rates of subsidy, and domestic resource cost coefficients.[70] In each case, these coefficients were calculated according to traditional methods, and then calculated again accounting for institutional costs as reported by individual firms and as estimated by AIRD. These institutional costs were used to estimate an export tax equivalent for each firm, calculated as the sum of the unnecessary fees and labor costs associated with export procedures and the foreign exchange premium lost by having to convert foreign exchange earnings

[70] See Annex B for details of the calculation of these coefficients.

into local currency at the official, rather than the parallel, rate of exchange.[71] Dividing this by the FOB value of exports, expressed in terms of the parallel rate of exchange, we obtained the implicit export tax rate. Institutional costs associated with imported inputs were calculated as an implicit import tax. All these institutional costs were subtracted from total nontradable costs.

The cost of converting 100% of foreign exchange earnings at the official exchange rate was estimated for firms owned by Malagasy citizens assuming no access to the parallel exchange market either in Madagascar or abroad. Firms owned by foreigners, on the other hand, were assumed to have access to such accounts, and to convert into local currency at the official rate of exchange only the FMG required to pay local costs. This overestimates the losses of these companies since most of them satisfy part of their local currency needs by converting offshore at the parallel rate of exchange. The institutional costs associated with loss of foreign exchange were estimated by calculating the difference between the amount of foreign exchange converted into FMG at the official exchange rate (1800 FMG/$U.S.) and what that conversion would have yielded at the parallel exchange rate (2000 FMG/$U.S.).[72]

Excessive costs of the administrative procedures associated with exports and the importation of inputs were calculated either on the basis of what the firm reported or by estimating the costs of tied up labor and capital, beyond that which could normally be expected (3 days), plus unnecessary fees and excessively high tips. Among the labor, fees, and tips that were considered as unnecessary were those used to obtain the *Domiciliation Déclaration Exportation et Engagement de Répatriation de Devises*, the *patente d'exportateur*, and authorizations from technical ministries with the exception of those involving food products.

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[71] For companies wholly owned by foreigners or for ZF companies, the foreign exchange loss was calculated only on the amount of foreign exchange required to be converted into domestic currency in order to pay local costs, since these companies are allowed to keep their export earnings in foreign exchange accounts. In cases where total sales included some portion of domestic sales as well as exports, calculation of coefficients assumed 100% exports, for purposes of comparison, unless cost figures were recorded exclusively with respect to exports.

[72] This parallel rate is the approximate rate in Madagascar at the time to which the survey applies. This undoubtedly underestimates the rate that existed offshore, especially in view of the practice that was instituted of *importation sans cession des devises*, which allowed importers to acquire foreign exchange overseas without going through the banking system. In addition, the parallel exchange rate was less than the free trade equilibrium, or shadow, rate of exchange because of the effects of import tariffs and other restrictions. The shadow exchange rate, used in the analysis to adjust world prices in the denominator of the domestic resource cost (DRC) ratio, was estimated at 2250 FMG/$, reflecting the assumption that the FMG was overvalued by 25% of the official rate of exchange. This was in line with the general level of import tariffs and with reasonable assumptions regarding elasticities of supply of exports and of demand for imports, but it probably underestimated the effect of informal quantitative restrictions on imports operating through the banking system, in view of the large depreciation that took place after the FMG was floated in May 1994.

2. Results

The results of this analysis are presented in Table IV-7. This table permits several conclusions, each of which must be tempered by the fact that the sample is neither random nor large enough to permit broad conclusions about exporters in Madagascar in general. Nevertheless, evidence pertaining to the firms surveyed is clear and highly suggestive of what is likely to be found for a broader sample of firms.

1. Of the 14 firms for which data were available to estimate comparative cost and incentive indicators, 7 firms have been approved under the investment code, 3 are in the *Zone Franche*, and 1 was wholly foreign owned.

2. The firms cover a range of sub-sectors including traditional exports of coffee and cloves; nontraditional agricultural, livestock, and marine products; processed foods; wood products; clothing; semi-precious stones; and miscellaneous manufactures. They also span a broad range of firm sizes.

3. The implicit export tax rate resulting from institutional costs varies from a low of 3.3% for a firm that has both Code and Zone status to a high of 37.8%, though this latter is exceptional since none of the other firms has an implicit export tax rate higher than 15%.[73] Nevertheless, 11 out of 14 rates are in excess of 10%, implying substantial export disincentives.

4. All the firms that were surveyed and completed this part of the questionnaire are operating efficiently by world standards (DRC < 1). In a few cases, such as litchis/raphia, medicinal herbs, fois gras, pickles, and one garment firm, the DRC is very low, reflecting Madagascar's strong comparative advantage in these activities.

5. Institutional costs have a significant effect on the DRC indicator. The average decline in the DRC coefficient across all firms is .045, once institutional costs are extracted from total costs.

6. The nominal rate of protection (NRP) is zero for all firms, given the lack of any explicit export taxation. The adjusted NRP on output varies from -3% to -14%, except for the one firm for which it is -38%. It is generally lower in absolute value for Zone firms. This suggests, as was supported in the regression analysis, that being in the Zone not only benefits firms insofar as duty-free inputs are concerned, but it also facilitates the clearance process and avoids them having to lose much on their conversion of foreign exchange.

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[73]The firm with an implicit export tax rate of 37.8% had a particularly costly experience because a technical ministry deliberately held up its approval in order to give a competitor an advantage. Although this was an unusual occurrence, it indicates the risks that are involved when the government plays an important role in regulating private sector operations.

TABLE IV-7
COMPARATIVE COST AND INCENTIVE INDICATORS

Status	Product	Export Sales (000s FMG)	Implicit export tax rate	DRC	Adjusted DRC	NRP output	Adjusted NRP output	NRP input	Adjusted NRP input	ERP	Adjusted ERP	ERS	Adjusted ERS
C	Coffee/Horns	1724268	14.1%	0.53	0.49	0%	-14%	48%	48%	-4%	-18%	-4%	-18%
	Coffee/Cloves	3392193	10.0%	0.52	0.52	0%	-10%	47%	47%	-4%	-15%	-6%	-16%
	Litchis/Raphia	1500000	11.3%	0.26	0.24	0%	-11%	39%	50%	-2%	-14%	-2%	-14%
	Medicinal herbs	33000	37.8%	0.28	0.05	0%	-38%	13%	13%	0%	-39%	0%	-36%
	Cotton fibers	27000000	10.0%	0.88	0.87	0%	-10%	35%	36%	-5%	-16%	-6%	-17%
	Meat/Vegetables	2092528	10.4%	0.72	0.71	0%	-10%	44%	44%	-5%	-16%	-5%	-16%
	Marine products	1200000	10.1%	0.72	0.67	0%	-10%	11%	11%	-8%	-23%	-9%	-24%
C	Processed food	123566	11.9%	0.39	0.37	0%	-12%	30%	30%	-1%	-13%	-2%	-14%
ZF/C	Pickles	1200000	3.3%	0.30	0.29	0%	-3%	2%	2%	0%	-4%	-1%	-4%
C	Wood products	507500	13.4%	0.71	0.65	0%	-13%	37%	54%	-5%	-21%	-6%	-22%
FO/C	Clothes	2400000	9.5%	0.82	0.81	0%	-10%	49%	56%	-4%	-15%	-5%	-15%
ZF	Clothes	2163500	5.4%	0.46	0.46	0%	-5%	4%	4%	0%	-6%	-1%	-6%
ZF/C	Semi-precious stone	77740	11.9%	0.99	0.96	0%	-12%	27%	27%	-4%	-17%	-6%	-19%
C	Plastic bags	6175500	12.7%	0.70	0.56	0%	-13%	21%	26%	-21%	-44%	-24%	-46%

Note: DRC - Domestic resource cost
NRP - Nominal rate of protection
ERP - Effective rate of protection
ERS - Effective rate of subsidy

Status
C = Investment Code
ZF = Zone Franche
FO = Wholly foreign owned

7. The NRP on inputs varies from 2% to 48%. The lowest rates are for firms in the Zone.[74] Most other firms pay rates of duty on their imported inputs that total 25% or more. This is a major barrier to exporters of products that use substantial amounts of imported inputs in their production if the exporting firms are not within the Zone. The situation is even worse for most firms when institutional costs are taken into account. In a few cases, such as wood products, the institutional costs are very high.

8. The combined effects of negative protection on output and positive protection on imported inputs give rise to effective rates of protection that range from 0% to -21%. The negative ERP of -21% for plastic bags is a good example of what happens when a firm that uses substantial amounts of imported inputs -- in this case about one half of the value of production -- is not granted duty-free admission of these inputs. In other sectors, on the other hand, the share of imported inputs in the total value of production is relatively low, so that high rates of taxation of these inputs does not lead to very high levels of effective protection. This is particularly true of resource based industries. Effective rates of protection are especially low -- zero in this case -- for Zone firms that import most of their inputs since these are admitted duty free.[75]

9. Adjusting the EPC for institutional costs results in a substantial increase in the degree of negative protection. The range of the adjusted ERPs is -4% to -44%, with even the Zone firms experiencing some fairly substantial disincentives. The ESC follows a similar pattern. This is all the more serious when one considers that most import competing firms have positive rates of effective protection that are probably about 30% to 50% simply because of the level and structure of tariffs used for revenue purposes.

E. Case Studies

To integrate the quantitative and qualitative analyses presented thus far, it is useful to look at case studies of individual firms. Although these are not representative, they provide some important insights.

Firm A: wood products
Code, joint venture, 50% exports, resource-intensive

Firm A was created in 1987 for the production of intermediate wood manufactures. It qualified in 1989 under the *Code des Investissements* as a joint Malagasy/foreign venture with an Asian partner, and it began to export to Asia and Mauritius. Exports are currently equal to approximately 50% of sales, which total about 500 million FMG. The firm is resource-intensive, relying on indigenous woods as major inputs. It is less labor-intensive than other exporters, employing 110 people in production and

[74]The one exception to this is the firm that exports semi-precious stones. Unlike most of the Zone firms, which import most of their inputs, this firm purchases the bulk of its raw materials and other inputs locally. It does not pay taxes directly on these purchases, but it pays taxes indirectly on the inputs used to mine the stones, produce the electricity, and otherwise supply the goods and services that it purchases locally.

[75]Note that the *Zone Franche* firm that exports semi-precious stones and purchases most of its inputs locally has an ERP that is not very dissimilar from the ERPs of non-Zone firms.

another nine in management. The firm is reliant on imports of production equipment and inputs such as wood paste.

The firm notes several major problems with respect to imports and exports. First, the managing director estimates that the costs of import procedures and delays annually in terms of production stoppages can equal up to FMG 100 million, or 25% of average sales. In calculating the various indicators, we have reduced this figure to 2.5% of sales, and it still has a big effect. These delays are due primarily to import delays of up to five months for shipment and customs clearance of equipment by boat, or 45 days by air. The firm reports that no local supplier carries the necessary inputs with sufficient reliability for its operation. Moreover, when local stores carry the equipment or supplies, the quality is inferior and the price exorbitant.

The firm estimates that export procedures require from 15 to 60 days to complete, and cost up to 2 million FMG per shipment. While the specific export procedures were not delineated, export of wood products requires notification of and approval by the Direction des Eaux et Forêts (DEF) in addition to regular customs procedures.

The firm is operating efficiently by world standards, with a domestic resource cost coefficient of 0.71, but it could be operating more efficiently with an adjusted DRC of .65. The firm's implicit export tax rate is relatively high at 13.4%, reflecting the fact that institutional costs pertain to export as well as import procedures. A fairly high nominal rate of protection of 37% on inputs indicates that the firm is being taxed by existing trade policies: the NRP increases with the inclusion of institutional costs to 54%. An effective rate of protection of -5%, measuring the incentives to producers that affect prices of both outputs and tradable inputs, reflects the fact that this producer receives negative protection, i.e. that he is operating at a disadvantage on the world market given the trade distortions in Madagascar. Inclusive of institutional costs, the ERP drops much lower to -21%.

Firm B: marine products
No Zone or Code, Malagasy-owned, 100% exports, resource-intensive

Firm B is wholly Malagasy-owned and classified under neither the Code nor the Zone. Founded in 1989 as a middleman for export of marine products, the company exports 100% of its "production", which actually consists of the collection, refrigeration, storage, and export of fresh crustaceans to Europe and the Indian Ocean. The firm is resource-intensive, and non-labor intensive, employing 21 people but grossing 1.2 billion FMG annually (about $670,000). Value-added is high.

Major export constraints for this firm include refrigerated storage capacity at the airport, which limits volume, and capital for fixed investment. The firm does not import any inputs; it states that it is unable to import plastic bags because of delays in obtaining financing and foreign exchange. The firm notes that local bags are 30% more expensive but of a similar quality to imported bags. Although production slowed in 1991 due to political events, by September 1992, collection and processing had recovered sufficiently to export 2 to 3 containers per month of fresh, live seafood. Other constraints include a lack of personnel trained in handling this specialized product, minor problems in the regularity of air shipments, limited capacity of sea freight to the Indian Ocean, and domestic transport problems in the rainy season. There are also bitter complaints about the monopoly imposed on air freight by Air Madagascar. Export requirements include a certificate of origin and health from the Direction Pêche et

Aquaculture (no formal fee required but a customary tip of FMG 10,000 to 35,000) and a free certificate of origin from the Chamber of Commerce. Although the firm qualifies as neither a Code nor a Zone enterprise, it has periodically obtained exoneration from the TUT due to the high proportion of its production going to exports.

This firm is also efficient, with a domestic resource cost coefficient of 0.72, but, like Firm A, it could be operating far more efficiently if institutional constraints were removed, since the adjusted DRC is 0.67. The major source of costs in this case is revenue lost from overvaluation of the FMG and the firm's lack of access to foreign exchange. This cost alone is estimated by the firm at 240 million FMG annually, or 20% of FOB sales. The firm would also be taxed on its inputs, if they were imported, with the NRP for these inputs equaling 11%. The firm suffers from negative effective protection of -8%, and this coefficient shrinks to -23% after accounting for institutional costs, the most important of which result from the unfavorable rate of exchange it receives for its export earnings.

Firm C: plants and oils
No Zone or Code, Malagasy-owned, 100% exports, resource-intensive

Firm C exports medicinal plants and oils indigenous to Madagascar. It is wholly Malagasy-owned, qualifies under neither the Code nor the *Zone Franche* and exports 100% of its production to Europe. The firm is resource-intensive, non-intensive in its direct use of labor (employing five people) and small in comparison to other exporters. Total sales in 1992 were 33 million FMG. This firm provides an example of what many very small, indigenous exporters may experience in the Malagasy business environment.

Major export constraints for this small firm include irregularity of shipments (only one shipment in the first half of 1993), due reportedly to problems of authorization both by the government of Madagascar and by customs officials of importing countries. Like Firm A, Firm C estimates that the cost of these delays in terms of lost orders and low client confidence has reached 25% of total sales, or in this case over 8 million FMG. The authorization problems occur as a result of delays in export approvals from the *Direction des Eaux et Forêts*, and as a result of substandard crating and processing by shippers, which delays approvals in destination countries. The firm does not import any inputs.

The firm potentially has a strong comparative advantage, with an unadjusted DRC of 0.28 and a DRC adjusted for institutional costs of only 0.05. The reason for the large discrepancy is the heavy burden placed on the firm by administrative procedures, especially the requirements imposed by the *Direction des Eaux et Forêts*. The firm claims that these requirements have been used in a discretionary way to give one of its competitors an advantage. The implicit export tax rate of 37.8% may therefore indicate the magnitude of problems faced by many small Malagasy firms trying to get into the export business. This is also shown in the adjusted effective rate of protection, which equals -39%.

Firm D: garments
Zone Franche, foreign-owned, 100% exports, labor-intensive

Firm D is a foreign-owned manufacturer of garments founded in 1992. It is non-intensive in resource use, importing all of its primary materials, but quite intensive in labor, employing more than 400 people in production and management. It qualifies as a *Zone Franche* enterprise, and therefore is

able to import all of its materials tax-free as long as the agreement is presented with each import shipment and the goods comply with primary materials itemized in the original agreement. The firm's gross sales were approximately 2.2 billion FMG for the first six months of operations in 1992, and all of its production was exported, primarily to European markets.

Firm D notes three constraints on exports. One is adequately trained workers, and the firm has solved this problem by creating its own training school for production line labor. Another constraint is import delays. Although imports are tax-free, the firm spends an average of 15 days obtaining clearance and authorization for its imported primary materials, filing forms at the Ministry of Industry, the Ministry of Finance, and the Ministry of Trade. The third constraint is adequate and reliable export transport capacity in the form of available containers to carry finished goods by rail or road from the factory in the capital city to the port at Toamasina. Due to formal ties with foreign entities, the firm has no constraints on financing capital investment or working capital needs, and no problem accessing foreign exchange.

These institutional costs are minimal in the overall cost structure of the firm. The firm operates efficiently (DRC = 0.46), and accounting for institutional costs does not improve that efficiency dramatically. However, the delays associated with customs clearance and transport delays and capacity, plus the need to convert some of its foreign exchange earnings into local currency at an unfavorable rate in order to pay local bills, amount to an implicit export tax rate 5.4%, which is high considering all of the other advantages afforded this firm as a *Zone Franche* enterprise. The fact that the effective rate of protection is 0% before, and 6% after, adjustment suggests that most of the disincentives that the firm faces are due to institutional barriers rather than trade policy distortions.

Firm E: pickles
Code and Zone, Malagasy-owned, 100% exports, labor-intensive

Firm E qualifies both under the Code (1989) and under the *Zone Franche* (1992). Its business is in fairly simple processing, packaging, and export of agricultural produce to Europe. Although wholly Malagasy-owned, it is run by a foreigner who has made use of all of the benefits pursuant to both legal regimes. The business is labor-intensive, employing 65 full-time workers and providing income for another 800 rural farmers who provide the agricultural produce that is processed for export. Total sales were more than FMG 2 billion in 1991, but dropped to FMG 1.2 billion in 1992 due to the social and political disruption.

The firm reports no problems with imported inputs; they consist of a single item used for packaging that is not available locally. The firm has also experienced no problems with export procedures, and finds the sea freight capacity and procedures affordable and timely. The only problem the firm faces is that it is operating at full capacity and would like to expand production facilities but cannot due to the lack of medium and long-term credit. These costs are not included directly in the calculation of the coefficients or the implicit export tax rate. The only institutional costs borne by the firm stem from the labor required to clear customs. There is also the need to convert some foreign exchange into local currency at the bank rate These costs amount to 3.3% of total sales FOB. The costs are easily borne since the firm's DRC even after adjustment is a healthy 0.29.

F. Policy recommendations

The analysis thus far underscores the fundamental importance of the exchange rate for promoting exports and growth in the private sector. Thus the policy measures taken in May 1994 to allow the exchange rate to be determined by market forces, which resulted almost immediately in a large depreciation, were essential to encouraging nontraditional export growth. In addition, the narrowing of the margin between the interbank and parallel market rates of exchange reduced substantially the cost to exporters of having to convert most of their foreign exchange earnings through the banking system.

The analysis also suggests that several other short and long-term policy initiatives could contribute to export growth. Short-term measures include increased ability of exporters to retain foreign exchange, faster and simpler procedures for exports and importation of imported inputs, implementation of a scheme for duty-free admission of imported inputs under the *droit commun*, and opening of the Air Madagascar air freight monopoly to competition. Longer term measures include infrastructure development for improved intermodal transport and cargo transfer, continued liberalization of the financial sector, and judicial reform.

1. Short-term Measures

a. Implementation of Loi No. 91-014 12/08/1991

Even though the losses associated with exporters having to convert their foreign exchange earnings to FMG through the banking system have been substantially reduced with the interbank float, the potential still exists for those losses to increase should the central bank intervene either directly in the interbank market or by exerting pressure on the banks to restrict their allocation of foreign exchange to importers. This creates uncertainty among exporters, given the experience of the past, and inhibits investment in export activities. The only way to lessen this uncertainty is to allow exporters to hold their earnings as foreign exchange.

Certainly, a ministerial *décret* implementing once and for all the law that permits Malagasy businesses to hold foreign exchange accounts (*Loi No. 91-041 12/08/1991*) would encourage exports, reduce the gap between foreigners and Malagasy, and provide equal treatment for firms inside and outside the *Zone Franche*. It would also decrease the government's ability to maintain an overvalued FMG since importers would not be forced to go to the banks to obtain foreign currency. This would help to assure fewer and less severe price distortions biased against exports.

b. Faster and Simpler Procedures for Trade Clearance

Second only in importance to the exchange rate is the ability of traders to move goods in and out of the country with a minimum of delay and cost. The delays associated with customs clearance affect every exporter and importer regardless of their legal status and nationality, though Malagasy exporters appear to suffer longer delays than foreign exporters. The government could either increase the resources of the *Direction des Douanes*, to provide better implementation of existing regulations and procedures, or reduce the costs of those regulations and procedures by decreasing their number and complexity. Clearly, the latter option is more consistent with the overall goals of increasing efficiency.

A reduction in the number and complexity of export and import procedures would greatly relieve the demands placed on the limited customs service. Elimination of the *Domiciliation Déclaration Exportation et Engagement de Répatriement de Devises*, which would no longer be necessary if exporters were free to retain 100% of their foreign exchange earnings, would help. So would the elimination of the need for approvals from technical ministries, except in the case of food products where health considerations are important and where relevant certifications are generally required by importing countries. Finally, although the *patente d'exportateur* is a convenient way for local governments to raise revenues, it constitutes an export tax when exports already suffer, as we have seen, from a number of other disincentives.

Establishment of a *guichet unique* is another option for reducing the time and complexity of export and import clearances without increasing the costs of the *Direction des Douanes*. A single office empowered by the relevant ministries to rule on issues of health, authenticity, and other standards could reduce costs for firms and the frequency of shipment delays. The *guichet* could consolidate its operations at key embarkment points, such as the port at Toamasina and the Ivato airport, with other agents available for on-site checks prior to packaging. The government already has some experience with a *guichet unique* created to facilitate approvals under the investment code. The *guichet* need not constitute a new layer of inter-ministerial bureaucracy. It could be established, instead, as part of a broad-based institutional effort to increase the efficiency and improve the standards of the *Direction des Douanes* within the finance ministry.

c. Duty-Free Admission of Imported Inputs

Even in the absence of export taxes, the effective rate of protection on exports is negative if there are duties or other taxes on imported intermediate inputs. This contrasts with import-competing activities, where the effective rate of protection is positive because taxes on imported inputs are usually more than offset by the protective effects of taxes assessed on imports of the final product with which the local activity is competing. To overcome this export disincentive, exporting countries throughout the world have established mechanisms for allowing firms to use imported inputs in the production of exports without payment of duty or other taxes. Some of these mechanisms also exist in Madagascar, in principle if not in practice. As discussed earlier, these include the *zone franche*, the *régime suspensif des droits*, and exemption from the TUT if exports total more than 75% of total sales.

As we have seen, the *zone franche* scheme in Madagascar works fairly well, though firms within the Zone are not totally free of administrative delays and other procedural difficulties. The main problem with the scheme, however, is that it effectively discriminates in favor of larger firms, often owned or controlled by foreigners, that are highly oriented towards the export market. In contrast, smaller, Malagasy-owned firms that produce only partly for the overseas market find themselves faced with high taxes on imported inputs. This results in their having to depend on locally procured inputs, which may be more costly and frequently are of poorer quality. As a result most of these firms tend to export resource-intensive products, which benefit from the scarcity value of Madagascar's natural resources and require few other inputs. Yet over the longer term, Madagascar's comparative advantage is likely to evolve towards the production and export of labor-intensive goods, such as garments, which have a relatively high content of imported inputs.

Although the *régime suspensif des droits* is occasionally used by some of the larger, more export oriented firms, it is not at present an effective way of admitting imported inputs duty-free. The approval process is far from transparent and is subject to abuse. Many firms do not even know about the procedure. Similar problems exist with the TUT exemption based on exports totalling 75% or more of total sales. In this case, there is also discrimination against firms that export less than 75% of their total sales volume.

The Malagasy government is currently reviewing its special incentive programs to see (1) how the disparities between these and the *droit commun* can be reduced and (2) how to reduce the abuses that occur in the implementation of these programs. The objective is to have a single set of incentives available to all firms, but with adequate controls to assure that these incentives are not abused. A major problem to date has been that control by customs is executed manually, which takes time and increases the likelihood of error, discretionary decisions, and abuse. Computerization is essential to effective operation of any incentive scheme. This would permit rapid and accurate tracking of a firm's export-import operations. Sets of input-output coefficients could be calculated and used to determine duties and other taxes owed or paid. Consideration is also being given to going to a drawback system whereby credit would be given for duties paid on goods used in the production of exports, with this credit redeemable at the time that future taxes are due. Drawback systems have not functioned well in Africa, however, and the time that a firm's capital would be tied up could be critical.

d. Increased Competition among Freight Companies

The constraints imposed on exports by air and sea freight could be lifted quickly through a few major policy changes. These include liberalization of domestic and international air cargo operations and opening up the market to cargo carriers other than Air Madagascar/Air France. In addition, lifting of the requirement that *cabotage* (using smaller vessels for coastal trade) be limited to vessels flying the Malagasy flag would open competition in this fundamental service.

2. Long-term Measures

a. Infrastructure Development

Streamlining the regulations and inefficiencies surrounding intermodal transfer of imports and exports (i.e., from railroad car or truck to cargo ship) would relieve a major constraint to efficient transportation. Some of the shipping capacity problems and customs clearance problems could be solved through creation of terminal and storage facilities in Antananarivo (plus a terminal at the airport) and in Toamasina. These facilities could provide headquarters for the *Direction des Douanes*, refrigeration facilities for lease by smaller entrepreneurs, and a collection point for containers, which are currently in constantly short supply at either end of the Antananarivo-Toamasina line. The terminals would also provide, of course, a locus for intermodal transfer of cargo and would optimize connections among rail, road, and air.

In addition, improvement in the road network would lower the cost of collection and transportation of all export products, but especially those that are produced or gathered over an extended area. Together with improvements in internal telecommunications, this would enable firms to respond much more quickly to overseas market opportunities.

b. Financial Sector Development

Madagascar is already well on its way to deepening the financial sector. The reforms that were launched with the 1988 Banking Law, initiating privatization of the banking sector, have profound implications for the export trade. Continuation liberalization and freeing up of the private sector will continue that process, but this must be accompanied by improved (not increased) regulation by public authorities to ensure transparency, improve contract enforcement, and increase the public's faith in the banking system. Especially important is the movement away from credit controls as a means of rationing foreign exchange, since this creates enormous uncertainty and discriminates against the smaller Malagasy exporter. Instead there is a need to improve access to the modern financial instruments of world trade and to the term capital required for fixed investment.

c. Judicial Reform

Perhaps the most sweeping reform that is necessary to reduce institutional constraints to nontraditional export growth in Madagascar is the development of the rule of law. While resorting to international arbitration represents a reasonable short-term solution, it is not ideal over the longer term because of its costs and unfamiliarity to many Malagasy entrepreneurs. Comprehensive legislative reform is needed with respect to business registration, the commercial code (which dates in certain places to colonial times), the power of judges to make law, the code of civil procedure, arbitration, export regulations (where inconsistency remains as a result of the adoption of conflicting laws), regulation of foreign participation, and banking law.

V. COMPARATIVE ANALYSIS

On the basis of the two country studies that have been presented and the experience of other countries, it is possible to draw some interesting comparative conclusions and to formulate some hypotheses regarding the relevance of these conclusions for other countries. Most of these conclusions relate to the institutional environment that exists in Africa and the kinds of distortions in incentives that it creates. These distortions must be considered, however, in relation to the kinds of products that are being exported and the evolving nature of Africa's comparative advantage. They must also be seen within the light of the demands placed upon exporters by today's competitive world markets and the bias against exports inherent in most African economies.

A. Africa's Evolving Comparative Advantage

For many years, Africa's comparative advantage has been seen as being based principally on traditional primary products. This is because the natural resources used to produce these products were thought to be abundant relative to supplies of labor and capital. It was to Africa's advantage to exploit these "surplus" resources in order to maximize its national income and earn the foreign exchange required for investment in further economic growth.[76]

Although this dimension of comparative advantage is far from exhausted in most African countries, it is pretty much exhausted in some, and in others the prospects for this sector serving as the motor of growth in the future are dim. In some instances, this is because world market opportunities are limited. This is the case with cocoa, for example, for which growth of world demand is relatively slow, there are no good substitutes in consumption that can be displaced, and competition among suppliers has become increasingly fierce. In other instances, demand constraints are less important than those of supply. This is true, for example, of declining timber reserves in many African countries.

At the same time that the prospects for traditional export growth are declining for many African countries, there are new opportunities in the area of nontraditional exports. One example is the growth of demand in the richer nations for tropical fruits and vegetables, which now occupy a special section in many supermarkets. Another is the expansion in the marketing of Afrocentric products to include a number of department store chains. Third, though exports of timber are declining in many countries because of supply constraints, those of processed wood products are rising because of ready access to cheap labor and raw materials and because demand for high quality hardwood furniture, builders materials, and other products is rising. Finally, a number of African countries are beginning to be taken seriously as sources of cheap, but efficient, labor for the production of standardized products, such as garments, that are produced using labor-intensive techniques.

The cases of Ghana and Madagascar are illuminating in this respect. Each country has the ecological conditions that permit it to export a number of products for which production is intensive in the use of natural resources. For both countries, these include horticultural crops, seafood, and wood

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[76]This phase of development corresponds to what Hly Myint has called the "vent-for-surplus" period of economic growth. Hly Myint, "The 'Classical Theory' of International Trade and the Underdeveloped Countries," *Economic Journal*, Vol. 68, 1959, pp. 317-37.

products. With its rich variation in ecological and geological conditions, Madagascar also has a substantial comparative advantage in the exportation of spices, legumes, rice, livestock products, fibers, medicinal plants, and semi-precious stones. Ghana, on the other hand, is in reasonably close geographical proximity to Europe, which gives it a comparative advantage in exporting products such as pineapples. Likewise, Madagascar benefits from being in the southern hemisphere, with access to the South African and Indian Ocean markets and with the capability of producing winter season crops.

The two countries also have similarities and differences with respect to their comparative advantage in the production of manufactures for export. Each country appears to have an advantage in the production and export of standardized labor-intensive goods, such as garments, though this is only beginning in Ghana, whereas Madagascar has several years of experience and wage costs there are somewhat lower (see Table IV-1). There is also the question of whether investment in the garment industry in these two countries is being undertaken primarily to avoid the restrictions of the Multifibre Arrangement (MFA) rather than to take advantage of low labor costs. However, although avoidance of these restrictions is undoubtedly a benefit, there is also evidence that unit labor costs in the production of standardized garments are sufficiently low in Africa to be competitive with regions of low labor cost in Asia.[77]

There are two areas in which Ghana appears to have a comparative advantage over Madagascar. One is in the export of Afrocentric products, where African origin is a key element in marketing. The major question here is how deep this market is, especially if a large number of African countries begin exporting to it. The second area is exports by Ghana of manufactured goods overland to neighboring countries. In the recent past, these exports may have been substantially inflated because of the overvaluation of the CFA franc. On the other hand, because of proximity and low transportation costs, there is probably scope for some level of intraregional trade within West Africa beyond that which is based on clear lines of comparative advantage, such as Ghana's exports of salt.

How can this comparative analysis be applied to other countries? There are several hypotheses that can be generated. The first is that most countries have a comparative advantage in a number of different types of nontraditional exports based on ecological and geological conditions, pools of low cost labor, rich cultural history, proximity to neighboring markets, and other elements. Very often the absence of one element underlying a country's comparative advantage implies the presence of other elements. In Madagascar, for example, the areas that are particularly rich ecologically produce the spices, tropical fruits, medicinal plants, seafood, and other natural resource based products that are exported, while the labor used in the production of garments comes primarily from the highlands, where population pressure on the resource base is high and wages are low.

A second hypothesis is that most African countries have products that they can export for which comparative advantage is sufficiently high that they do not have to be extremely competitive on world markets. This is particularly true of the products for which comparative advantage is based on ecological or geological conditions or on cultural history. These are the products that the firms of a country can export while they are learning to become more competitive in terms of their packaging, quality control, and timeliness. With their competitive edge assured by geography or history, they can

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[77]Tyler Biggs, *et al*, "Africa Can Compete!..."

afford to make some mistakes during this period before they embark on the more difficult standardized products for which competition is much keener.[78]

B. Competition in Today's World Markets

As the world economy becomes more integrated and demanding, countries must compete with each other not only in terms of price but also in terms of quality and timeliness. In today's competitive market, lower price is not as easily substituted for lower quality as in the past. Legislation and the trend toward standardized products have made quality control an important element in buyers' decisions. African firms need to implement management measures that will guarantee the quality of their goods. This task should not be the sole responsibility of the individual firms, but due to its externalities, of the professional associations and other quasi-public groups as well. Countries tend to have a general reputation for their goods rather than a reputation for the goods of specific industries. Therefore, unless there is a general positive consensus concerning the quality of a country's goods, it is harder to attract buyers or to receive a premium on quality products.

Particularly for manufactured exports, quality control permits standardization, which in turn allows small firms to obtain economies of scale by sub-contracting or being sub-contracted. Since African firms are characteristically small and often do not have the capital requirements to expand production in order to meet large exporting orders, sub-contracting provides a means of exporting despite fixed capital constraints. Small firms are likely to be more successful specializing in one part of the product chain rather than struggling with whole product process. Therefore, standardization of product and manufacturing processes ensures these firms of greater compatibility with outside firms and products.

There are two components to timeliness: the production cycle and the distribution cycle. For the most part, the firm has almost complete control of the production cycle; however, for items such as imported inputs, the firm can be vulnerable to outside influences. The distribution cycle, though partially in the firm's realm of control, is more a reflection of the country's infrastructure and its ability to expedite transactions. The shorter the time period for these two cycles, the more the firm has control over the chain of events and the better the firm's response time to its clients.

From an importing firm's point of view, one of the key constraints on doing business in much of Africa is inadequate telecommunications. The situation today is, in fact, appalling in many countries with respect to both internal and external communications. In this day and age of instantaneous communications, there is little tolerance for delayed responses. Yet many firms in Ghana and Madagascar still use messengers as a major means of basic communication. Without improved telecommunications, African firms must continue to depend on established informal trading relationships versus relationships created through formal networking or advertising, since these latter relationships often require more proof of legitimacy because the parties are unknown to each other. Lack of direct, expedient communication seriously undermines this legitimacy.

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[78]This idea extends that of Nural Islam, referred to earlier, by broadening beyond horticultural crops the range of goods that serve as a natural bridge to exports of manufactured goods. Islam, *Horticultural Exports* ....

Aside from business contacts, adequate telecommunications can shorten production cycles. If firms are aware of a delay, they can take action to prevent it, e.g. ordering inputs from another supplier, rather than waiting through the delay. Reaction and turn around time is reduced. Electronic data transfers also reduce the time spent on communicating orders, shipping, and payment information.

Investing in quality control and time-saving infrastructure and operations pays off. These two attributes attract buyers, who generally want long-term relationships with only a few suppliers to keep transaction costs and response time down. In fact, some 46% of transcontinental trading relationships are more than 10 years old. African firms can benefit from cooperation with foreign firms in terms of gaining technical and marketing exposure.

The distribution cycle entails the infrastructure which the supplier must work with. Just-In-Time (JIT) manufacturing methods are increasingly being desired, which means cuts in transportation time are important. Transport infrastructure systems in Africa must be improved to support this need. Buyers are interested in moving stock quickly -- instead of having a 6-week stock, now they only want 1.5 weeks worth. This translates into suppliers having to make more frequent and smaller shipments, increasing the burden placed on transportation infrastructure.

C. Bias Against Exports

In view of this highly competitive world market, exploitation of Africa's evolving comparative advantage in nontraditional exports is seriously impeded today by the strong bias that exists against exports. This bias occurs for two major reasons. The first is overvaluation, which creates a bias against exports in favor of nontradables. Although both Ghana and Madagascar have reduced the overvaluation of their currencies enormously by eliminating most controls on imports and foreign exchange, there is still some overvaluation because taxes on imports allow balance of payments equilibrium to be maintained at an exchange rate that is appreciated in relation to the equilibrium exchange rate that would prevail if there were no import taxes. The second, somewhat related, bias occurs because import taxes tend to protect the import-competing sector, attracting resources towards this sector and away from the production of exports. Both the bias due to overvaluation and that which occurs within the tradables sector are, to a large extent, unintended by-products of taxes imposed primarily for revenue purposes. Yet it is difficult to reduce these taxes because governments in Africa do not have the administrative capacity to rely more heavily on direct taxes as a major source of revenue.

Subsidies and other measures to promote exports could be used to offset these biases. Even in the absence of the biases, a strong case can still be made for the active promotion of nontraditional exports based on the important benefits that may be derived by African nations from expanded international trade. The evidence continues to mount from other parts of the world, as well as from the experience within Africa, that economic growth is closely interlinked with foreign trade. Aside from the usual economic arguments associated with efficiency of resource allocation due to the exploitation of comparative advantage and economies of scale, there are a number of other ways in which trade contributes to economic growth. These include using trade and associated investment as a conduit for technological transfer, increasing the efficiency of enterprises forced to compete on foreign markets, expanding the commercial and managerial competence of entrepreneurs, augmenting the skills of the work force, creating a market for labor in the face of growing population pressure, increasing foreign exchange earnings that can be used to import capital equipment, and a host of other factors.

Assuming that trade is desirable, the question remains as to whether the benefits from trade accrue equally regardless of whether exports, especially nontraditional exports, are directed at overseas markets or to neighboring countries. Overseas markets present the advantage that their demand for nontraditional exports from Africa is relatively elastic (an hypothesis that needs to be tested), their contribution to the transfer of technology and managerial knowhow is potentially great, and the range of goods that may be exported is virtually inexhaustible. On the other hand, transportation costs can be considerable, standards of quality and timeliness of delivery are high, and contracts may be difficult for African exporters to enforce.

The data gathered from the surveys in Ghana and Madagascar throw some interesting light on this issue. Although firms with a larger value of total sales contribute the most to nontraditional exports, they do not represent the most dynamic element in the export sector. Instead, it appears that smaller, younger firms are more heavily specialized in exports and are more likely to find niche markets in the industrial countries, rather than simply expanding into neighboring countries as the older, larger firms have done. Ways should be found to facilitate linkages between these younger firms and foreign partners, which could play a vital role in helping them to penetrate overseas markets.

For these firms to survive successfully in this environment, however, it is critical that institutional constraints be reduced to a minimum. There may even be a case for providing preferential access to loans or some form of subsidization, as occurred in some of the East Asian countries.[79] In any event, the recommendations that follow should be seen in the light of trying to make nontraditional exporting firms as competitive as possible.

D. Legal, Regulatory, and Judicial Environment

The discussion in Chapter II noted the importance of a legal, regulatory, and judicial environment that is propitious for the growth of nontraditional exports. It referred to Douglass North's work showing the development within northern Europe of institutions that reduced transactions cost by increasing mobility of capital, lowering information costs, and spreading risks. Fundamental to this institutional development were (1) limits placed on the arbitrary intervention by government in the market place and (2) legal and judicial systems that provided for the establishment and maintenance of property rights, the enforcement of contracts, and the resolution of liability disputes. This institutional framework permitted the emergence of complex impersonal forms of exchange that were essential to capture the economic benefits of modern technology.

The investigations conducted as part of the two case studies suggest that this type of institutional framework is sorely lacking in Africa. Prior to approval of Ghana's new constitution in 1992, administrative mechanisms rather than the rule of law were used to implement economic policy. This contributed to the short-term success of the structural adjustment program because it greatly simplified decision-making, but it also undermined the confidence of the business community and its ability to achieve judicial relief from government violation of property rights. This situation was exacerbated by the inability of the courts to keep up with the volume of litigation. As a consequence, the government created regulatory agencies such as the Ghana Investment Center to replace the statutes and independent

[79]World Bank, *The East Asian Miracle*, Washington: 1993.

courts in the protection of property rights and enforcement of contracts. This inevitably introduced a large degree of discretionary authority, which created uncertainties for potential investors. Although efforts are underway to reduce regulation, which is frequently perceived by the business community as being both excessive and arbitrary, the development of a legal and judicial system capable of taking its place will be a very slow process.

A similar situation exists in Madagascar, where numerous inadequacies of the legal and judicial system have been documented related to commercial law, dispute resolution, competition law, and judicial independence. The legal and judicial system is so entangled in inconsistencies, ill developed jurisprudence, and misplaced discretionary authority, in fact, that it is widely perceived to be ineffectual and unreliable. The situation is severely aggravated by the political turmoil of recent years from which the country is only beginning to emerge.

Despite the inadequacies of the legal and judicial system perceived by the business community, few firms listed this as a serious constraint on the expansion of nontraditional exports. Instead, they have found ways of working around the system that involve personal relationships, family and school ties, political favoritism, and even outright bribery. Although this reduces the problems normally resolved in the advanced countries through the application of business law, it has two important consequences. First, as described by North, it reduces the scale of activities by preventing the emergence of complex impersonal forms of exchange. Second, it severely biases the incentive structure in favor of the rich and powerful, preventing the emergence of less advantaged, but potentially dynamic, smaller entrepreneurs. How important a factor this is in inhibiting the expansion of nontraditional exports, we can only guess, for the present. This is an important topic for future research, however, if substantial resources are to be devoted to improving legal and judicial systems in Africa.

During the period to which the survey applied, very few exporters noted examples of high level government interference in their business operations. Yet one would not have to go back many years to reach a period in each country when this type of interference was commonplace. One of the major problems of replacing a legal and judicial system with government regulation is the potential for wide-scale abuse. Without constraints on the use of its power, the executive branch of government has in many African countries interfered extensively and often arbitrarily in the business sector. Aside from the immediate harm that this causes, it also vastly increases perceived uncertainty on the part of the business community, and this may discourage investment for many years.

E. Institutional Distortions

In addition to the limitations and biases imposed by the lack of a viable legal and judicial environment in most African countries, there are a number of important distortions in the institutional structures of these countries that are inhibiting the expansion of nontraditional exports. A comparison of the institutional environments in Ghana and Madagascar reveal some important similarities, despite their varied colonial histories, but there are also substantial differences. The major constraints imposed by these environments on the expansion of nontraditional exports tend to be quite similar. These include (1) restrictions on exporters' retention of foreign exchange earnings, (2) lack of duty-free access to imported inputs, (3) slow and costly procedures for clearing exports and imported inputs, (4) lack of access to term finance for fixed investment, (5) lack of access by smaller firms to working capital, (6) problems in the implementation of special incentive schemes, (7) lack of competition for air and sea freight, (8)

inadequate transportation and telecommunications, (9) excessively complicated or restrictive regulations regarding land and labor, (10) lack of qualified skilled labor and middle-level managers (11) and problems in contract enforcement with overseas importers. These problems are summarized here and their generalization to other African countries is in some cases assessed. Recommendations are subsequently offered as to what actions might be pursued.

1. Restrictions on Exporters' Retention of Foreign Exchange Earnings

Historically, the most important disincentive to exports, traditional as well as nontraditional, has been overvaluation of the exchange rate. During the early 1980s, the cedi in Ghana may have been overvalued by as much as 2400%.[80] Although overvaluation in Madagascar was never as great as this, it nevertheless posed formidable problems for the export sector from the mid-1970s until very recently.

Where exchange controls are in place, with exporters required to turn their foreign exchange earnings in to the banking system or exchange authority rather than being allowed to retain these earnings or to exchange them for local currency on the private market, the potential for an export disincentive exists. The severity of this disincentive depends on the difference between the rate at which exchange conversion takes place through the official, regulated market and the rate that exists on the private, parallel market that is found both within the country and offshore.

During the year to which the surveys in Ghana and Madagascar applied, 1992, the costs associated with controls on exporters' use of their foreign exchange earnings were higher than they are today, especially in Madagascar, where 100% of earnings had to be converted to local currency at an exchange rate that was quite unfavorable.[81] Exchange controls have now been substantially liberalized in Ghana, with exporters allowed to retain their earnings in foreign exchange accounts in Ghana. Exporters are still required to submit the Exchange Control Form A2 to their bank, however, which charges a fee equal to 1-1.25% of the FOB value of the shipment (0.5% of which goes to the central bank). The banks use this procedure to exercise some monopoly power over their customers when they convert part of their foreign exchange earnings into local currency to pay bills or for other reasons. This requirement is substantially more liberal than in Madagascar, where Malagasy exporters today can retain only 10% of their earnings as foreign exchange. This requirement is highly discriminatory, moreover, since foreigners and firms in the *Zone Franche* need only convert what they need into local currency.

Because the rate of exchange at which exporters now obtain local currency in each country is determined today largely by the inter-bank market for foreign exchange, and this inter-bank rate does not differ very much from the rate on the parallel market, the cost of these remaining controls is not very

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[80]J. Dirck Stryker, *Trade, Exchange Rate, and Agricultural Pricing Policies in Ghana*, World Bank Comparative Studies, The Political Economy of Agricultural Pricing Policy, Washington: World Bank, 1990, p. 300.

[81]The degree of overvaluation of the FMG on the official market vis-à-vis the parallel market that was assumed in the comparative costs and incentives calculations was only about 10%. This was probably a considerable underestimate, even for that year. In the ensuing period, up to May 1994, this difference grew considerably, heavily penalizing Malagasy exporters.

great. Nevertheless, the potential for policy reversals induces uncertainty, which inhibits investment. Furthermore, the problem is much more acute in countries that have currencies that are seriously misaligned.

2. Lack of Duty-Free Access to Imported Inputs

Both Ghana and Madagascar suffer from lack of duty-free access to imported inputs despite the fact that each has formal mechanisms to provide this access. In Ghana, the most important mechanism is the duty drawback system, but it is seldom used. Efforts are underway to improve the effectiveness of this system by setting up a special fund, established by a USAID project, to speed the drawback process, but there is little experience with it to date. Procedures also exist for duty exemption and the maintenance of bonded warehouses, but these are available mostly to larger firms, and they tend to be fraught with discretionary authority that is subject to abuse. In addition, there is no systematic mechanism for duty-free admission of imported inputs used indirectly in the production of exports.

In Madagascar, the situation varies markedly depending on whether of not a firm is within the *Zone Franche*. Those that are approved under this scheme are able to import their inputs duty-free with relatively little administrative inconvenience. Although Zone status is open to all firms that export close to 100% of their production, in practice only those of a certain size generally apply and are approved. Firms outside the Zone that export more than 75% of their production can be exempted from taxes paid on locally purchased inputs, but the procedures are cumbersome and there is no relief for firms that export less than 75%. All firms are eligible for temporary admission without payment of taxes of imported inputs used in the production of exports, but in practice only the larger exporters use this procedure, which is subject to discretionary approval and considerable abuse.

The cost of not having duty-free access to imported inputs is considerable, especially for the firms that engage in the labor-intensive production of standardized goods made mostly of imported materials, such as the garment industry. In Ghana the nominal rate of protection (NRP) on inputs for the firms in the survey ranged from 5% to 39%. The NRP on inputs for 12 out of 17 firms was in excess of 15%. In Madagascar the NRP on inputs was even higher, ranging from 2% (a *Zone Franche* firm) to 49%, with 10 out of 14 firms having a NRP on inputs in excess of 20%. This factor alone resulted in an effective rate of protection (ERP) in Ghana ranging from -4% to -30% and an ERP in Madagascar of from 0% to -21%. Given the competitiveness that exists in world markets, especially for standardized products, and given the other biases against exports described above that are largely unavoidable, this level of negative protection resulting from taxation of inputs is intolerable if African countries are to succeed in expanding their nontraditional exports.

3. Slow and Costly Procedures for Clearing Exports and Imported Inputs

In each of the case study countries, exporters listed slow and costly procedures for clearing exports and imported inputs as a significant problem, despite the fact that major strides have been made in recent years in simplifying these procedures. One problem is that clearance of goods through customs becomes a convenient way of assuring that companies have complied with legal and tax obligations that have nothing to do with their trade activities. The most obvious example is the requirement in Ghana that companies obtain a certificate from the Internal Revenue Service showing that they have paid all of their income taxes each time that they process a shipment for export or import. In Madagascar,

exporters are required to purchase a local export license, as a means of raising funds for local governments, despite the principle formally accepted that exports should be exempt from all taxation.

Another problem is the delays often experienced in clearing customs. These delays vary substantially from one exporter to another and depend on the personal relationships that have been established with particular customs agents. Tips often facilitate these relationships, but they are not a major cost. Not all companies are as adept in this process as are others.

A major problem is the special authorizations required from technical ministries before exports are allowed to clear customs. The procedures involved in exporting furniture and wood products from Ghana are particularly onerous, but the approvals required in Madagascar for exports of mineral products, wood products, and handicrafts also cause major delays. In a few cases, the failure or delay in gaining approvals has resulted in lost orders that have been very costly. Another problem is lack of coordination between customs and the technical ministries.

In both Ghana and Madagascar, exporters report that delays in clearing imported inputs are longer than those involving exports. This is even true of firms in Madagascar that are included within the *Zone Franche*. Despite this, for most companies the cost of these delays is less than the costs involved in clearing exports because most firms do not import many inputs. Nevertheless, these delays, which can last up to several months, can be critical if a firm is to meet its delivery schedule.

4. Lack of Access to Term Finance for Fixed Investment

Lack of access to term finance for fixed investment was cited by exporters in both countries as a major constraint on the expansion of nontraditional exports. This was somewhat paradoxical in Ghana because many firms there are operating well below full capacity, but much of the equipment that exists is old, outmoded, and in disrepair. This appears to be less true in Madagascar, where most firms are operating close to full capacity. One reason for this difference is that exporting firms in Ghana tend to be older than in Madagascar. Many firms in Ghana were established originally to supply the domestic market and are now exporting to neighboring countries, whereas most exporting firms in Madagascar were established after the initiation of reform, with the overseas export market principally in mind.

The major reason for lack of term finance is the poor state of development of each country's financial markets. Part of the reason for this has to do with the history of inflation, poor banking practices, and general economic malaise, which took its toll on the balance sheets of the banks and other financial institutions and has made them highly risk averse. Second, neither of these countries has yet established a macroeconomic environment that is sufficiently stable with respect to prices, interest rates, and exchange rates to reduce to reasonable levels the actual risks associated with term finance. Finally, the legal and judicial system functions so poorly that lenders have an extremely difficult time foreclosing on delinquent borrowers. As a result, commercial banks, merchant banks, and other lending institutions have preferred to confine themselves to lending working capital and to the purchase of relatively safe, and often high-yielding, government securities.

As a result exporters are dependent on their own sources of finance, which are generally quite limited, or on financing from a foreign partner, where one exists. Some efforts have been made by donors to provide term finance through special credit lines, but these have encountered difficulties in the

face of inflation, depreciating exchange rates, and other disturbances. Furthermore, the administrative procedures involved with these schemes have been sufficiently long and complex and the requirements for borrowing have been so stringent that many exporters have either chosen not to participate or have been unable to do so.

Other efforts to facilitate investment in fixed capital have involved insurance, credit guarantee, and leasing companies. Experience with these is relatively brief, however, and much of that has been confined to the larger, better established firms, which have relative good access to capital from other sources as well.

5. Lack of Access by Smaller Firms to Working Capital

Although few firms listed lack of access to working capital as a major impediment to the expansion of exports, it is clear that this poses problems to smaller firms, many of which have had relatively little banking experience. Shipments by these firms are often relatively small, making it difficult to cover the cost of obtaining letters of credit, even if they knew how to go about obtaining these letters. Given their lack of credit experience, loans to these firms are considered risky, but the backing of these loans with collateral is difficult because of their lack of financial assets, problems with control of inventories, and legal difficulties in foreclosure on real property. Efforts are underway, in Ghana especially, to increase the availability of short-term capital to smaller exporters through partial credit guarantees, but there is not yet enough experience to evaluate these schemes.

6. Problems in the Implementation of Special Incentive Schemes

Both Ghana and Madagascar make extensive use of special incentive schemes for the promotion of investment. Madagascar also has the *Zone Franche* scheme to encourage exports, and the government of Ghana is considering introducing a similar scheme. Yet experience with these schemes has not been uniquely favorable. Because the schemes establish a separate set of incentives for firms that are approved under them compared with the tax and other incentives that are available to all firms (*droit commun*), the institutions responsible for policing these programs have tended to take on a regulatory role rather than one that is essentially promotional. Furthermore, obtaining approvals under these schemes can be long and time-consuming, and there is often a degree of arbitrariness to the decisions that can lead to abuse. One of the most disturbing aspects of these schemes is that in practice, if not in principle, they are often biased in favor of foreign investment. In any event, it is unclear why investment or export incentives should be restricted to an subset of "approved" firms rather than be available to all firms that meet the requirements.

This appears to be increasingly recognized in both Ghana and Madagascar. In Ghana, the new investment code is to put much greater stress on promotion as opposed to regulation. The approval process is also to be simplified and accelerated. In Madagascar, the investment code is being revised to allow firms to receive benefits only after investments have been made. A *guichet unique* has also been established to facilitate the approval process by having all ministries and other agencies represented in one place. Experience to date with these innovations is very limited, but the question remains as to whether it would not be best to simply extend the benefits received under these schemes to all firms that meet the requirements regardless of whether or not they have been "approved".

7. Lack of Competition for Air and Sea Freight

Many of the overseas transportation problems that Africa faces today result from lack of competition for air and sea freight. Much of this is due to the low volume of export activity, which prevents freight companies from bidding actively against each other on both freight charges and shipment delays. As an example, charter air freight planes often have to stop in several African countries in order to fly to Europe reasonably full. Furthermore, to reduce costs Ghana is served mostly by ships that are southbound, resulting in a voyage to Europe that can take 17 to 20 days. This leads to delays that result in damage to shipments, especially of horticultural crops. Madagascar faces similar anomalies. These problems should eventually be overcome as volume increases.

On the other hand, lack of competition can also be engendered by government regulation. The most obvious example is the state monopoly conferred on Air Madagascar/Air France in the shipment of air freight. This results in prohibitively high air freight rates for many exporters, leading to unused capacity and missed market opportunities. In addition, competition in coastal sea trade is limited by the requirement that vessels engaged in this trade fly the Malagasy flag.

8. Inadequate Transportation and Telecommunications

The importance of timeliness and quality control in today's export market was emphasized above. The ability to assure these depends very much on a country's transportation and telecommunications infrastructure. Orders need to be accurately received and acted on quickly, and goods of proper specification and quality need to be delivered to the importer on time. Often windows of market opportunity are open for only a short period, and unless they can be exploited quickly, they are lost.

Most African countries do not have the transportation and telecommunications infrastructure that is necessary to meet this requirement. As a result, importers are reluctant to place orders with exporters that they perceive as being less than fully reliable. This is already a problem for exporters of primary resource based and Afrocentric products. It will become even more acute as exports expand of standardized products, for which timeliness and quality control are especially important competitive elements.

9. Excessively Complicated or Restrictive Regulations Regarding Land and Labor

The two country case studies highlight the cumbersome and complex regulations that exist regarding the use of land and labor. Land registration is often made complicated by the juxtaposition of customary and modern systems of land tenure. The failure to comply with all registration requirements can be extremely costly and long delays are frequent. The system of land registration established in Ghana in 1986 was designed to provide transparency, speed, and timeliness in the handling of matters concerning acquisition. Problems remain, however, because of the failure to publicize clearly the procedures to be followed in registration. In Madagascar, the situation is even worse. Foreigners may not own land, and the process by which nationals may acquire title is fraught with obstacles.

Both domestic and foreign-owned Firms in Ghana must go through the Ministry of labor for recruitment of personnel, rendering the hiring process lengthy and uncertain. Retrenchment of workers must be negotiated with unions and powerful political groups, often making it a very difficult process.

Similar difficulties confront firms in Madagascar, though those approved under the investment code and *Zone Franche* are often exempt from these requirements. Many companies in both Ghana and Madagascar skirt the labor regulations by hiring mostly temporary labor.

10. Lack of Qualified Labor and Middle-level Managers

Lack of qualified semi-skilled labor and middle-level managers is a perennial problem in countries such as Ghana and Madagascar, which are embarking on the production of new products for export. Government technical schools are not generally a good solution to this problem because the training provided by them is often not what is needed. It is better if the training can be undertaken by the private sector. Frequently, foreign partners can provide assistance. To some extent, training is accomplished within individual firms, but there are obvious spillovers since much of the training is not very firm specific. Consequently, there is a case for the government to find some means of supporting training undertaken by professional associations or individual firms when that training applies to the industry or the economy as a whole, as well as to the needs of the association or firm.

11. Problems in Contract Enforcement with Overseas Importers

A number of firms complained about occasional problems in the enforcement of contracts with importers overseas. This was particularly true in the horticultural industry, where exports are frequently made on consignment due to the perishable nature of the product. It is often difficult for a firm to dispute an importer concerning the poor condition of the product on arrival and the consequent discount made on the payment to the exporter. But this is a common problem with world trade in agricultural products. It is usually resolved by engaging a reputable surveyor to assess the damage and to recommend adjustments in payments or insurance claims.

F. Recommendations

1. Restrictions on Exporters' Retention of Foreign Exchange Earnings

The potential danger that results from controls on exporters' retention of foreign exchange earnings are enormous. Given the biases against exports that are unavoidable, because of the need to raise public revenue by taxing imports, it is imperative that exporters be given every encouragement possible. This has been a significant lesson of the experience in East Asia, and it needs to be transferred to Africa. Where countries such as Ghana and Madagascar have moved their exchange rates to realistic levels and have in place mechanisms to make swift exchange rate adjustments, there is nothing to be gained by maintaining controls on exporters' earnings of foreign exchange. These should be totally eliminated. Experience has shown that this does not result in a massive flight of capital. Rather, exporters are encouraged to repatriate their foreign exchange earnings in order to pay their recurrent cost obligations and finance new investment.

In other African countries, and especially in those of the CFA franc zone, no mechanism for automatic exchange rate adjustment exists. This creates problems if the local currency becomes overvalued, as the CFA franc did prior to January 1994. There is then a tendency for the central bank or exchange authority to try to hoard as much foreign exchange as possible, usually resulting in a tightening of controls on exporters' retention of foreign exchange. While there may be cases in which a

fixed exchange rate can be maintained without some form of exchange control, the record to date in Africa is not encouraging. It remains to be seen whether the CFA devaluation in January will be sufficient to avoid some form of exchange control for exporters in these countries. Elsewhere, at least, it seems clear that elimination of controls on exporters' earnings of foreign exchange must be closely linked with the maintenance of a realistic exchange rate.

2. Lack of Duty-Free Access to Imported Inputs

Procedures for granting duty-free access to imported inputs must be made more automatic, must reduce the discretionary authority of public officials, and must eliminate the bias in favor of large firms and firms that export most of their production. Fortunately, this is becoming increasingly possible as customs processing is becoming more computerized. With full computerization, it will be possible to maintain records on the history of imports and exports of individual companies. Sets of coefficients can be constructed, by firm or by industry, indicating the import content, both direct and indirect, of exported goods. Using a formula based on past export history, firms could be granted temporary duty-free admission of imported inputs up to a certain limit. Verification would occur when the final products were exported. If exports by the end of the year were insufficient to justify the duty exemptions granted, the firm would be liable for back taxes, and its duty-free admission limit would be lowered by the formula. Beyond this limit, firms would have access to drawback of duties paid on imported inputs once the final products were exported. A similar system could be used for excise, value-added, and other indirect taxes paid on inputs, whether imported or purchased locally.

Systems such as this have been used in East Asia and elsewhere for several years. It would be very useful to examine the experience with these systems in order to determine how well they work and what problems have been encountered. But it is also important to bear in mind that what has worked well in Asia might not work so well in Africa. Thus it is important to monitor the experience in Africa as governments try to come to grips with the problem of providing duty-free access more systematically and to a broader range of firms.

3. Slow and Costly Procedures for Clearing Exports and Imported Inputs

Detailed recommendations are presented in the case studies regarding the elimination of unnecessary export procedures. Approval of technical ministries should be required only to assure that health and safety standards are adhered to, as is the case with food products. Every effort should be made to publicize widely the requirements that exist and to assure that these are as simple as possible. Computerization is essential to speed the process. It may also be necessary to hire more customs agents.

4. Lack of Access to Term Finance for Fixed Investment

Over the longer run, a market for term finance will develop spontaneously in Africa as financial systems become stronger and deeper. It is unclear how much this process can be accelerated without substantial subsidization, which most African countries cannot afford. Furthermore, subsidized credit schemes inevitably involve discretionary decisions regarding who has access to loans, and this runs counter to the general tenure of financial reforms, which has been to make lending more transparent and automatic as long as borrowers are willing to pay market rates of interest. Nevertheless, there may be ways in which term financing can be facilitated through the exploitation of economies of scale and

diversification involved in such activities as leasing, insurance, and loan guarantee. These financial innovations should be strongly supported.

In the final analysis, however, the most effective way for governments to encourage the development of a market for term finance is through the maintenance of macroeconomic stability. Low rates of inflation, positive real rates of interest, and a stable exchange rate reduce the risks associated with financial intermediation and help to assure the financial viability of borrowers, making term finance more attractive to lending institutions.

5. Lack of Access by Smaller Firms to Working Capital

Insurance and loan guarantees may also play a useful role in helping small firms to gain access to short-term credit for working capital. Equally important, these firms need assistance in establishing banking relations, filling out loan applications, setting up accounting systems, and learning about other commercial and financial practices that are required if they are going to enlarge their scale of export operations. Frequently, this type of assistance can be incorporated into projects for the promotion of nontraditional exports, such as the Trade and Investment Program project in Ghana.

6. Problems in the Implementation of Special Incentive Schemes

The trend in both Ghana and Madagascar is towards making special incentive schemes such as the investment code or *Zone Franche* more promotional and less regulatory, simplifying and accelerating the approval process, and providing benefits after, rather than before, requirements have been met. The next step would be to incorporate these incentives directly into tax and other codes so that they would be available to all firms that met the requirements rather than just those that are approved. This would allow the agencies responsible for administering these schemes to become truly promotional. By definition, this approach would also eliminate delays and costs incurred in obtaining approval and would be based on *ex post*, rather than *ex ante*, justification. Most important, this approach would eliminate most of the discretionary authority involved in the approval process and would reduce the bias that exists against smaller, local firms.

7. Lack of Competition for Air and Sea Freight

While little can be done about the lack of competition for air and sea freight that results from the low volume of export activity, the same is not true of the monopoly conferred on Air Madagascar/Air France in the shipment of air freight. This legal monopoly on domestic and international operations should be eliminated and open competition should be encouraged, including the use of private air cargo planes as soon as the volume of activity makes this profitable. In addition, lifting the requirement that coastal trade be limited to vessels flying the Malagasy flag would also increase competition in this service.

8. Inadequate Transportation and Telecommunications

Although this report is not concerned primarily with infrastructure, it is evident that poor transportation and telecommunications not only increase costs but also have an important institutional consequence in that they limit a country's ability to respond to the exigencies of today's world markets,

which require good timing and quality control. As a result, one cannot stress too much the importance of dealing with these problems as quickly as possible. Priorities identified in the case studies include vastly improved internal telecommunications in both countries. This may require such innovative approaches as expanded use of wireless systems, such as cellular telephones, that do not depend on heavy investment in central infrastructure. Other priorities for Madagascar include expanded and improved port capacity and improved secondary, and in some cases primary, roads. There is also the need for a freight terminal in Antananarivo.

9. Excessively Complicated or Restrictive Regulations Regarding Land and Labor

Few firms mentioned labor and land regulations as important problems inhibiting the expansion of nontraditional exports. One reason for this, in the case of labor, is either that the firms are exempt from these requirements because of their being approved under one of the special incentive programs or that they simply hire labor temporarily so as to avoid the requirements. In neither instance are the requirements being complied with, though their existence may make firms reluctant to hire new workers. It would be preferable, therefore, to liberalize substantially the hiring and firing of labor so as to enable firms to rid themselves of unproductive workers and to adapt flexibly to changing economic circumstances.

Although most firms in the surveys did not cite problems with land registration as being very important, there are enough instances in which they have been important that there is a need to take action. In Ghana, much could be accomplished by simply publicizing very clearly the various steps that must be taken to register land and by noting the severe complications that can occur if each of these steps is not taken in the order required. In Madagascar, the situation is more complicated because of the absence of up-to-date and clearly written legislation regarding land registration. The passing of this legislation should have high priority.

10. Lack of Qualified Labor and Middle-level Managers

Means should be sought for governments to support the private sector in its training of labor and middle-level managers for the nontraditional export sector. This support could take the form of tax credits to individual firms where the training would carry benefits that the firm is not able to capture fully. Alternatively, the public sector could join with professional associations in developing training programs at the industry level.

11. Problems in Contract Enforcement with Overseas Importers

Problems of contract enforcement are common in international trade and institutional means exist to overcome them. One of the most common is to engage the services of a reputable surveyor to assess damages. This is often done by the importer, with the surveyor's report made available to the exporter. Exporters should insist on such a procedure whenever damage claims are made.

G. Research Conclusions and Recommendation

1. Research Conclusions

There are a number of important conclusions for research that emerge from the application of the methodology described in Chapter II and Annex B to the two case study countries -- Ghana and Madagascar. These conclusions are discussed here, followed by a list of research topics that are recommended based on the experience of this study.

The first conclusion is that it is possible to measure quantitatively some, if not all, of the costs associated with institutional barriers to the expansion of nontraditional exports and that these costs are considerable even in countries that have undertaken fundamental economic reform. The costs that were successfully measured in Ghana and Madagascar are those related to (1) controls on exporters' use of foreign exchange earnings, (2) lack of workable procedures for duty-free admission of imported inputs, and (3) unnecessary administrative delays and procedures involved in the clearance of exports and imported inputs.

These costs are treated in the following manner. First, to the extent that the barriers result in an underestimate of the true value of exports, as when firms are required to convert foreign exchange earnings into local currency at an unfavorable rate of exchange, the domestic resource cost (DRC) as conventionally measured is too high and comparative advantage is underestimated relative to its true value. The difference between the value of exports measured at the rate of exchange actually received and that measured at the rate that would exist if there were no exchange controls is equivalent to a tax on exports.[82]

Second, the costs resulting from lack of workable procedures for duty-free admission of imported inputs are considered to be the import tariffs and other taxes actually assessed on these inputs. These are treated in the conventional manner and are not labeled as institutional costs, though in fact inputs would probably be admitted free of duty if it were possible to devise and implement workable procedures for their duty-free importation.

Third, the costs of labor and capital required because of unnecessary delays and procedures involved in the clearance of exports are the equivalent of a tax on exports. These are subtracted from the numerator of the DRC and are added to any direct export taxes that may be imposed plus the export tax equivalent resulting from exchange controls. The costs of labor and capital needed because of unnecessary delays and procedures involved in the clearance of imported inputs are the equivalent of an import tariff on these inputs. These are subtracted from the numerator of the DRC and are added to any other taxes assessed on imports.

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[82]Note that applying this correction is not equivalent to valuing exports at the free trade equilibrium, or shadow, rate of exchange, which also takes into account the effects of tariffs, taxes, and quantitative restrictions on imports that cause the local currency to be overvalued. Both corrections are necessary and in fact were made to obtain the DRCs in Chapters III and IV.

The net effect of these costs is very substantial for many firms. An unweighted average of effective rates of protection resulting from these costs equals -18.8% in Ghana and -18.6 in Madagascar. This is a very high rate of negative protection for firms trying to compete in the world's export markets, even before taking into account the additional bias against exports resulting from overvaluation of the exchange rate and positive protection for the import-competing sector. Thus application of the methodology to even this limited range of institutional barriers reveals their importance.

There are a number of other costs associated with institutional constraints that have not been measured. These include lack of access to capital, problems in the implementation of special incentive schemes, lack of competition for air and sea freight, effects on quality and timeliness resulting from inadequate transportation and telecommunications, excessive regulations regarding land and labor, lack of qualified labor and managers, and problems in contract enforcement with overseas importers. There is also the bigger issue of the weak legal and judicial systems that characterize the entire African continent.

The reasons for the difficulty in measuring the costs associated with these constraints are several. In some instances, such as lack of access to capital, it is not clear how much the problem is due to fundamental factors related to development and how much it is due to impediments amenable to policy change. In other instances, such as the problems linked to special incentive schemes and to the regulation of land and labor, not only are the costs difficult to measure but also it is hard to determine to what extent these costs impede the expansion of nontraditional exports. Finally, as with the problems of contract enforcement reported by exporters, it is not always clear to what extent real costs are involved or there is simply the need for better information.

As mentioned in Chapter II, a number of steps were originally envisioned in the methodology that were not carried out because of data limitations and because of the desire to limit the results to those that could be most solidly substantiated. One such step was the estimation of supply functions for each export product studied and the calculation of the impact of each major constraint on the total quantity and value of these exports. The major difficulty involved in this calculation would have been the estimation of supply functions, given the lack of data on costs of different firms and on the potential for expansion in each industry. Were some of these data to be gathered at the industry level, this calculation could be made. In the meantime, we could gain at least some indication of the potential losses resulting from each constraint by examining the data that lie behind the comparative cost and incentive indicators presented in Tables III-3 and IV-7.

Finally, we have not yet tried to measure quantitatively the costs associated with removing institutional barriers to nontraditional exports. We have made qualitative assessments, however, in deciding whether a barrier should be treated as a real cost or as an institutional cost amenable to policy change. In addition, once a cost has been identified as institutional, recommendations have been made regarding its removal, though the costs of this removal, which may be largely political in nature, have not been assessed.

Despite these limitations, the research methodology is sufficiently developed that it can be extended fairly easily to other African or, for that matter, non-African countries. This should normally require about one month initially to review documentation, interview knowledgeable public officials and business people, and set up the survey of exporting firms. The survey can be conducted and analyzed and the draft report can be prepared during the ensuing three months, after which a second visit to the

country should be scheduled to discuss and verify the results and to gather any further data. The final, revised report should be available within six months of the project's initiation. This report would identify the major institutional constraints on the expansion of nontraditional exports and would estimate the quantitative importance of the costs associated with those constraints. It would also make specific recommendations regarding policy changes that can be implemented in the short to medium term, as well as discuss longer term impediments to trade that need to be resolved.

2. Research Recommendations

In order to improve the effectiveness of these studies and to sharpen the recommendations arising out of them, there are a number of research topics that need to be pursued. Most of these have been identified previously in this report and are brought together here in order to present a preliminary research program.

Areas of Comparative Advantage. Further work is needed to identify areas of comparative advantage for African countries related to nontraditional exports. Patterns of international trade are changing rapidly with the growth of high-value agricultural products, quality handmade goods, products with a particular cultural origin (Afrocentric products), products finding niche markets, and standardized products for which production at varying stages may take place in several different countries. Research needs to be undertaken to identify these products, to assess Africa's comparative advantage in producing and exporting them, and to see what institutional constraints inhibit the exploitation of this advantage. An important element of this research is to understand better the extent to which Africa needs to be highly competitive today or has time, because of ecological or cultural factors, to develop the institutions required to achieve that competitiveness.

Overseas versus Regional Markets. An important issue is the advantages and disadvantages associated with exporting to overseas versus regional markets. To what extent is the overseas demand for nontraditional exports from Africa more elastic than regional demand within Africa? Is there a better transfer of technology and managerial knowhow if exports go overseas? Are overseas markets more difficult to break into than regional markets? Are contracts more difficult to enforce? Is it true that younger firms tend to export overseas whereas older firms have a greater tendency to export to neighboring countries? If so, what does this say about the best way to foster contacts between domestic exporters and foreign importers?

Controls on Exporters' Earnings of Foreign Exchange. There is a great need to study the types of controls that governments place on exporters' earnings of foreign exchange and the costs that these impose. In many cases in which there has been substantial liberalization of the exchange system, governments still exert pressures on exporters, through the banking system or by other means, to convert their earnings into local currency. Even if the exchange rate is unified, that is the bank rate and the parallel market rate are the same, the effect of this pressure is to increase artificially the demand for local currency, thus leading to its overvaluation. In other countries in which formal controls are still in place, the impact on the profitability of exports can be devastating (e.g., Madagascar prior to May 1994). Of special concern is the extent to which controls exist today within the CFA zone, where these countries are trying to maintain a fixed exchange rate at a new devalued level.

Duty-Free Admission of Imported Inputs. High priority must be assigned to the establishment of mechanisms for the duty-free admission of imported inputs used in the production of exports. A study should be undertaken immediately of how these schemes have worked in East Asia and other developing countries, with a view to adapting them to African conditions. In addition, the efforts underway in countries such as Ghana and Madagascar to improve the procedures for duty-free admission or duty drawback should be carefully monitored to see how well and under what conditions they work. An assessment should also be made of how increased computerization of the customs service can create opportunities for innovations that were not possible when all processing and record-keeping was done manually.

Improved Access to Finance. A number of efforts are underway to increase the availability of finance to the export sector for both fixed investment and working capital. These efforts include innovations involving leasing, insurance, and credit guarantees. They need to be monitored and their results evaluated. Studies of the development of trade finance in other countries, such as those of East Asia, need to assessed with respect to their relevance for Africa at its current stage of development.

Special Incentive Programs. Some countries in Africa are beginning to experiment in their use of special incentive programs designed to encourage investment and exports. Attempts are being made to make these programs more promotional rather than regulatory, to simplify and speed up the approval process, and to use *ex post* rather than *ex ante* criteria in meeting requirements. In some instances, such as Madagascar, consideration is being given to eliminating the special programs altogether and to incorporating the incentives directly into tax codes and other laws that apply to all firms equally. These experiments need to be monitored closely to see how well they work and can be applied elsewhere.

Quality Control and Timeliness. Quality control and timeliness are likely to become increasingly important features of competitiveness in international trade. The ability to achieve these depends critically on good transportation and telecommunications, but where these are lacking, as they often are in Africa, what are the options and priorities for investment? For example, are there some products for which quality control and timeliness are less important than for others, and can African nations try to move ahead first in these? Is it possible to leapfrog over the need for massive investment by using more decentralized infrastructure such as cellular telephones? Which infrastructural investments should receive the highest priority? How have other developing countries dealt with this problem, or did they start to export before these requirements became so important?

Contract Enforcement. What are the standard procedures used throughout the world for enforcement of international contracts and why are these not being used more by African exporters? Is the problem one of lack of information or is it related to costs? What are the problems, if any, associated with the use of surveyors to assess damages? Would the use of factoring agents be a practical solution?

Legal and Judicial System. The legal and judicial systems in Ghana, Madagascar, and most other African countries, leave a great deal to be desired. They are slow, costly, and uncertain. Yet exporters do not indicate that this is a major problem. The hypothesis is put forward above that this lack of concern is because firms have found informal means of conducting their business and more formal mechanisms are not required for protection of property rights and enforcement of contracts. But the work of Douglass North and others suggests that a strong legal and judicial system is critical to the

expansion of commercial activity because it permits the emergence of complex impersonal forms of exchange. Thus, while the lack of such a system may not be much of a problem today, it is likely to become an increasingly important constraint in the future. This hypothesis needs to be tested and an assessment needs to be made as to when this constraint is likely to become binding.

Measures to Promote Exports. Given the strong bias that exists against nontraditional exports, it is important to investigate ways in which this bias might be offset by active measures to promote exports. A number of these measures have been undertaken in Asia, but it is often argued that Asian conditions are so different with respect to the quality of the civil service, the ability of governments to finance subsidies, and other areas that the lessons of Asia have little relevance for Africa. This assumption needs to be examined carefully, especially if comparisons are made with Southeast Asia rather than East Asia, which is relatively more advanced. Among the active measures that have been used in Asia to promote exports are credit subsidies and guarantees, income tax deductions, accelerated depreciation, special rates on public utilities, and marketing assistance.

3. Final Conclusion

Despite its limitations, the methodology described in this report has proven itself to be highly useful in identifying and measuring the costs of a number of important barriers to the expansion of nontraditional exports. It has also revealed how significant the bias against nontraditional exports still is despite all of the progress that has been made in countries such as Ghana and Madagascar. While the methodology is sufficiently well developed that it can operationally be applied in other countries, there is a strong case for continuing the research effort along the lines proposed here in order to strengthen our knowledge of these institutional barriers and how they can be most effectively overcome.

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COSTS AND BENEFITS OF ELIMINATING INSTITUTIONAL CONSTRAINTS ON THE EXPANSION OF NONTRADITIONAL EXPORTS

ANNEXES

October 1994

by

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and
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ANNEX A: LEGAL, REGULATORY, AND JUDICIAL ENVIRONMENT

General Legal System and its Implementation

As countries attempt to liberalize their economies, policymakers stress economic policy and its effects, often bypassing the structure of rules, institutions, and practices that govern business transactions in the private sector. As Gray has pointed out, however, in the wake of economic structural adjustment it is often the legal, regulatory, and judicial environment that harbors the most egregious barriers to efficiency.[1] With the retention of legal systems designed by the former colonial powers to restrict fluctuations in price, supply, and markets, often in wartime, many developing countries are attempting to enter 21st-century markets with 18th-century codes and regulations.

Douglass North describes how in Western Europe the rules and enforcement mechanisms designed to reduce transaction costs and manage a growing volume of trade emerged from the merchants themselves rather than from regulation by governmental authorities.[2] In northern Europe, the emergence of mercantile law transcended state boundaries, literally and figuratively, in response to the need to establish common rules of the game. Carrying mercantile codes of conduct with the tradable cargo, merchants were responsible for the merging of Pisan laws with sea codes of Marseilles and introduced to northern Europe Italian concepts of insurance and bills of exchange.[3] The state became an integral player in the evolution of trade law, primarily as the protector of property rights and enforcer of contracts as the frequency of impersonal exchange increased. The role of the state as regulator of trade and commerce gave way in the 19th century to government being less concerned with market control and limitation than with establishing the security to ensure market efficiency and predictability.

Separation of powers

Closely associated with this trend was the increasingly distinct separation of legislative, executive, and judicial power. An independent judiciary is crucial to the maintenance of a viable system of property rights, contracts, and torts, and is therefore fundamental to an efficient and transparent legal, regulatory, and judicial system.

Problems of arbitrary exercise of executive power. One common source of prejudicial justice is unbridled executive authority. The potential for direct intervention by a country's executive branch in matters that belong in the realm of due legal process can substantially inhibit the efficient functioning of the private sector. While such intervention may be "legal" by virtue of a nation's constitution and tradition, a harmful imbalance of power can take any one of several forms.

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[1] Gray, Clive S. *Reform of the Legal, Regulatory, and Judicial Environment--What Importance for Development Strategy?* CAER Discussion Paper No. 10. HIID, 1991.

[2] See, for example, North, Douglas C. "Institutions." In *Journal of Economic Perspectives*. Vol. 5, No. 1. Photocopy. 1991. PP. 97-112.

[3] Ibid., p. 107.

Frequently in countries characterized by political instability, the official legal system (i.e. the system of courts and procedures operated by the national government) is superseded for all practical purposes by a parallel legal system, often exercised through the military. In Chad, the constitutional provisions creating the legislature and the Supreme Court, as embodied in the Constitution of 1989, were suspended along with the rest of the Constitution by Idriss Déby soon after he staged a military coup in December of 1990. Déby enjoys broad legislative powers under the National Charter, which is acting as a temporary constitution. While the new Charter does not explicitly render illegal the legislature and the Supreme Court, these institutions remain effectively nonexistent in the aftermath of the coup.[4]

Legal systems characterized by unbridled executive authority need not be parallel and militarily based; they can also exist legitimately as the law of the land. In Ghana, for example, Flight Lieutenant Jerry Rawlings, as head of state, has used the rubric of business legal reform under structural adjustment to reinforce the power of the State and of the executive branch. By awarding broad discretionary power to the Ghana Investment Centre over certification, regulation, and legislation of investment, this public agency has been empowered to supplant the role of statutes and independent courts in the protection of property rights and access to markets for investors.[5] Legal reform has been supplanted by legitimization of the executive's monopoly over economic and political control.

In general, the problems encountered by the private sector in the case of an imbalance of power stem from three main sources: use of *arrêtés* and *décrets* (executive orders/regulations) to override laws and ordinances, direct influence exercised by the executive branch in individual judicial cases, and conflicts of interest, when commercial and political goals intersect. The result of all of these is increased uncertainty and market distortion.

More specifically, executive discretionary power can thwart investment and commerce through actual or threatened misuse of the right of eminent domain and violation of privacy (access by government authorities to private financial records, for example). Widespread abuse has been reported in Chad of the right of eminent domain, in which property is seized without compensation or compliance with other requirements of the law.[6]

Mechanisms for restraining executive power. Attempts to counter the potential for excessive executive power have generally taken one of two forms. In many Francophone countries, a system of administrative law exists explicitly to adjudicate disputes in which the "Government," meaning the executive branch and all of the ministries that fall under its jurisdiction, is a party. Thus, the term "administrative law" connotes something very different in

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[4] Louis Aucoin, "Current Status of the Legal System and the Rule of Law in Chad and Its Effect on the Private Sector," Center for Institutional Reform and the Informal Sector, University of Maryland at College Park. October 1992.

[5] Julien E. Naginski, "Economic Conditionality and Legal Unconditionality: Structural Adjustment in Ghana (1983-1992)." Unpublished draft, Fletcher School of Law and Diplomacy, Tufts University, Medford, MA. February 1993.

[6] Aucoin, 1992, p. 18.

France and francophone countries than in common-law countries. Whereas the French legal system in general operates on the principle of a strict and mechanical application of the written law, administrative law is "judge made."[7] Operative legal standards revolve around abuse of discretion, abuse of power, etc. Problems arise under this type of structure in the case of a limited system of appeals, and the susceptibility of judges and lawyers to corruption or interference (in response to either bribes or threats from outside sources, including the executive branch).

In anglophone countries, the Anglo-Saxon system of private challenge through regular courts, as embodied in the U.S. Administrative Procedures Act, for example, guarantees the rights of individuals to seek redress within an independent judiciary from governmental oppression or abuse or the invasion of privacy. Clearly, when the judiciary is less than independent from other branches of government, or when the authority of the judiciary to administer and enforce a judgement over a branch of the government is curtailed, the ability of the system to protect individuals is compromised.

Property rights

The role of government as securer of property rights is one that runs counter to both the body and spirit of existing law in many developing countries. In order to provide such security and assure the efficiency of markets, history has shown that government is best structured in such a way as to create an automatic system of checks and balances in order to limit the abuse of power by any one branch. In industrialized countries, such a system has been guaranteed through the separation of powers of the executive, legislative, and judicial branches of government. In many developing countries (and indeed in the history of many industrialized countries) the executive branch operates with impunity, leading to abuse of power, conflict of interest, and a myriad of more particular problems which thwart the emergence of a robust private sector.

Baseline. The baseline for measuring the adequacy of property rights is established norms and procedures within the international community, especially the former colonial powers. Rights of ownership are clearly established through a standard and uniform procedure of registration or deed. Owners of the property have full rights of alienation, including use as collateral, subject to clear identification of a secured interest in the property by a creditor. In the absence of explicit contractual terms, creditors may seek to exercise rights to that collateral through standard self-help mechanisms that guarantee due process for debtors but also protect creditors against premature liquidation of the property or transference by the debtor to a third party.

Many African countries do not require or allow for registration of a substantial amount of property, especially in rural areas. While most of these countries have adopted *de jure* many of the written laws of the former colonial power, *de facto* those laws are inconsistent with customary law and remain largely unknown and unenforced. While it could be argued, especially

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[7] Aucoin, 1992, p.17.

with respect to property rights, that traditional practice or customary law accomplishes sufficiently the goals of efficient and transparent rights to use and alienation, the fact is that development of international trading networks requires such rights to be transparent not only to local communities but also to potential investors and customers whose interests extend well beyond those communities. Baseline standards, therefore, will be defined here by concepts of property ownership and alienation inherent within English common law and French civil law and applied as international norms.

Limits on ownership and alienation. Rights to ownership of real estate, equipment, and inventories used in the production and processing of exports may be limited according to the type of owner recognized under the law (corporate, partnership, or individual) and the owner's right to use or to transfer the property in various ways. The law may recognize property as formally "owned" by an individual or business only after a registration process has been completed in which the owner and the goods are fully identified.

Limits to ownership are common with respect to real property. A government may recognize as "public" or commonly owned (or government-owned) any real estate that is not explicitly deeded. It then limits the extent to which certain types of real estate can be deeded to private parties, forbidding ownership, for example, of waterways, waterfront, forested land, or other real estate in which the state holds an explicit interest. The state may limit rights of ownership to resources associated with real property, such as energy and mineral deposits, fisheries, and wood. The state may also limit the type of individual or corporate entity that can be legally registered as the owner of real property, limiting foreign ownership or ownership by individuals of a certain ethnic groups, either explicitly or implicitly.

Registration of property may not clarify rights of alienation, which are often less clear than rights of ownership *per se*. The right to transfer full or partial interests in property becomes particularly important for the potential exporter when property is to be used as collateral. In the case of a loan obtained from a customer to finance the production or shipping of inventory, the establishment of a secured interest in property is often key to the completion of a contract. If secured interests are not recognized legally, or if the rights of creditors are not clearly distinguished from the rights of debtors, contracts that do not explicitly detail such rights may not be enforceable under the law, or, if enforceable, may not be enforceable through a timely and transparent judicial procedure. Similar problems can arise in relation to other types of secured interests, such as those pertaining to mortgages.

Cost and difficulty of registering. The registration process, itself, can present an onerous series of steps to be taken with respect to a particular state agency. Proof of purchase, taxes and fees paid, and deeds of sale or transference may be required to establish clearly that the property has been acquired legally and that all liens against it have been removed. Registration, therefore, may create opportunities for rent-seeking if the government entities in question retain discretionary authority over the setting and collection of fees and the completion of the process. Even in the absence of such discretionary authority, registration fees (levied on an *ad valorem* basis) or stamp duties can pose significant transaction costs to individuals and businesses. Extended delays in recognition of ownership by state agencies can also imply real costs to business.

Other problems may occur with real property. Titling to two individuals, for example, may not explicitly prevent sale or lease by only one of those owners, and the rights of the second are often unclear in relation to the rights of the first. Title to a particular piece of property may not be fully transferred in other ways. For example, when a new owner is registered, records pertaining to former owners may not be updated so that several owners are officially "registered" simultaneously. Additionally, problems concerning clear and adequate measurement of real property are common in the absence of standard, reliable survey practices. Such problems in registration often confound financing, real estate improvement, and investment in protection of land from degradation.

Limitation on use as collateral. With respect to use of real property as collateral for financing, or in the obtaining of a mortgage, laws may ascribe particular rights to creditors but not debtors (or vice versa) which create an uneven playing field and may or may not be subverted through a contract. For example, restricting the right to grant a second mortgage to banks not only interferes with freedom of contracting but also discriminates against other types of creditors and distorts the market for mortgage instruments.

Enforcement of zoning and construction restrictions and standards. A less than even-handed enforcement of rights to develop real property can amount to an investment disincentive. Suppose that a potential exporter observes zoning regulations applicable to a particular tract of land which is suitable for his exporting business. It is an area adjacent to a national border with highway access and could serve as the location for a warehouse. However, zoning regulations prevent commercial development and therefore the exporter chooses to lease a less ideal site, thereby increasing transportation costs. The original tract is then leased and developed by a competitor who has done so based on special (perhaps unofficial) exemption from the zoning regulations. The first firm not only suffers a comparative disadvantage, but operates less efficiently as a result of losing access to a superior site. If regulations concerning zoning and construction are not uniformly applied, therefore, markets for real property fail to fully reflect the value of those restrictions, often regardless of compliance. Opportunities for rent-seeking also arise in the discretionary application of rules which increase costs to investment and ownership.

Rent control and other leasing regulation. As is clearly evident in industrialized as well as developing countries, inefficiencies and market distortions arise not only from the lack of regulation, but also from regulation that explicitly seeks to distort markets for purposes of equity. Rent control is one method of capping growth in the costs of living or doing business, but it can lead to significant inefficiencies in the valuation of real property. Businesses that gain access to rent-controlled property or that cannot lease property at a fair market rate benefit (or suffer) from a distortion in the market that can translate into inefficiencies in the production and marketing of exportables.

Extension to the informal sector. By definition, businesses and individuals operating outside of the formal sector are not protected by the state in terms of their property rights. Property rights pertaining to the informal sector, therefore, most likely do not exist in a legal sense. What is important to investigate is the extent to which written or customary law recognizes squatters' rights, rights of alienation among family members or community members, or other traditional user rights based on common practice or cultural norms. Whether or not to

formalize such rights depends on the net potential benefits of doing so. While little literature exists on this subject, David Atwood theorizes that the benefits of introducing an efficient property rights system in an African context include promotion of transfers, access to credit and promotion of investment.[8]

Contracts

In general, the simpler and briefer is the law pertaining to contracts, the more able are potential exporters to operate freely within the market and maximize both productivity and returns to investment. However, certain areas of the law pertaining to contracts and torts, especially within developing countries, are worth considering with a focus on removing constraints to exports.

Baseline. Contract law is important for two major reasons. First, it increases efficiency by setting standards and norms for the writing of contracts, figuratively and literally through the standardization of certain contracts to set out legal terms for standard transactions or agreements. Second, it stipulates the ramifications for breaches of terms, in order to create incentives for signatories to avoid breach of contract. Setting out the terms for awarding of damages both clarifies ramifications of non-compliance (creating the incentive for compliance in most cases), and articulates the process through which damages may be sought. The efficacy of contract law will be determined using these two yardsticks.

As with most other legal areas to be studied, the baseline against which the adequacy of laws is measured lies in international convention, in this case, norms governing the enforceability of contracts and the existence of tort law. In more specific instances pertaining to international commerce, the baseline lies in such international conventions as the U.N. Convention on International Sale of Goods. This convention establishes a uniform law of commercial sales in international transactions and works to minimize uncertainty with respect to extra-contract liability, breach, and other areas of concern for many potential exporters.

Limitation v. clarification. One frequent attribute of contract law in developing countries is the tendency to use the law to limit the type or nature of contracts which are considered "legal." Terrell and Svejnar describe contract law in Senegal, for example, that prohibits certain types of contracts between employers and employees and prohibits layoffs by employers without government approval, significantly increasing production costs and negatively affecting the ability of firms to alter production in response to market conditions.[9] Barbara Ibrahim has argued that similar legislated limitations on contracts in many developing countries,

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[8] Atwood, David A. "Land Registration in Africa: The Impact on Agricultural Production." *World Development*, Vol. 18, No. 5, 1990. p. 663.

[9] Terrell, Katherine, and Jan Svejnar. *The Industrial Labor Market and Economic Performance in Senegal: A Study in Enterprise Ownership, Export Orientation, and Government Regulation.* Boulder: Westview Press, 1989; Velenchik, 1991, op. cit.

detailing such issues as maternity leave, limitations on the work week, etc., unfairly discriminate against women, making them more expensive to employers.[10]

Other aspects of contract law can clearly increase efficiency and equity. To continue to use the example of labor contracts, laws requiring withholding of taxes by employers, minimum age requirements, etc., can all fulfill social goals at the same time as they reduce transaction costs across sectors and across the society.

Role of economic efficiency. Where contract law often fails in the developing world is in maximizing economic efficiency. Contracts may enjoin parties to perform certain acts and meet obligations, but when circumstances change (market conditions, prices, transaction costs, or the legal regime), provisions to keep the meeting of contractual obligations subject to economic efficiency can relieve both the signatories and the judicial system of unnecessary waste. In general, potential exporters are particularly subject to fluctuations in market conditions and therefore can benefit most from built-in contractual flexibility.

Torts

Tort law seeks to encourage certain behavior through the threat of liability. Torts, *per se*, do not exist in the French legal tradition, but many of the concepts embodied in the tort law of common law countries exists in France and francophone countries under the rubric of *lois d'obligations* (law of obligations) and *responsabilité* (responsibility). The French legal concept of *responsabilité* assigns liability on the basis of duty dictated by certain circumstances of human interaction, and negligence of that duty by an individual or company. Given the disparate meanings of the concept of tort, here the term "liability law" shall be used to refer to the legal regimes pertaining to torts, responsibility, and liability.

While the scope of liability law in most African contexts is limited to personal injury causes, liability is an essential component of a legal regime to provide proper incentives to firms. Through the imposition of minimum standards of care and accompanying liability for breaching those standards, liability law encourages safety in the workplace and a reduction of adverse environmental impact in manufacturing. Most importantly to firms in the exporting sectors, liability encourages the implementation of quality control systems to ensure safety and health standards for goods sold. Therefore, the threat of pecuniary liability can serve to improve the quality of goods for export--something which is often cited as a key factor for increasing the exportability of African manufactured products to more sophisticated consumer markets. In assessing the efficiency of a liability law regime, three areas of analysis are critical:

1. **Transparency and predictability of the law**. The crucial issue is whether potential liability and responsibility is known by the firms, so that they can act proactively through implementation of safe operating procedures and the purchase of liability insurance. Clearly where duties of care and product safety requirements are imposed by statute

[10] Ibrahim, Barbara. "Policies Affecting Women's Employment in the Formal Sector: Strategies for Change." *World Development*, Vol. 17, No. 7, 1989. p. 1102.

rather than case law, the legal regime is more predictable. Another important factor for promoting predictability is the transparency and consistency of liability law administration (see contracts above).

2. **Costs of administration**. Central to the cost of administering the liability regime are the levels of damages generally imposed on exporting firms and the availability of liability insurance. In addition to liability, legal fees may add significantly to the cost of administering the tort regime. The right of lawyers to work on a contingency basis--common in the United States but rare and controversial in Europe--substantially raises a society's liability levels, as such payment mechanisms encourage more suits, especially those where plaintiffs are indigent and otherwise would not be able to bring their case to court.

3. **Scope of the liability regime**. In most developing countries, personal injury cases and trespass cases are adjudicated through either the modern court system or through customary law. Of concern for this study is the degree to which the liability law has evolved to allow product liability cases and class action suits, since these legal concepts are not operative in most developing countries.

Baseline. Establishing a baseline for assessing the efficacy of liability law is problematic. Although the United States operates the most extensive tort regime, the costs to private business are legendary. Using liability standards operative in the former colonial power is clearly preferable both for historical, cultural reasons and for reasons of balance between protection of potential claimants and economic efficiency. However, the efficacy of tort law is best determined on an individual country-by-country basis, employing a baseline that seeks to balance the needs for efficient redress by potential plaintiffs and the interests of the private sector in expansion of economic activity. The extent to which one set of interests is met to the detriment of the other should serve as a guide in recommending changes to the law.

Business Regulation

Corporate law

Baseline. Since the laws governing commerce are based in the English common law tradition, British and American concepts of corporate law offer the most suitable baseline for measuring the efficacy of corporate law in the developing countries to be studied. While regulations governing taxation, for example, vary considerably even among industrialized countries, the basic legal rubric which determines incentives to engage in private commercial activity is fairly standard across international boundaries. It provides for certain legal rights, obligations and protection for businesses conducting international trade.

Types of companies. Upon seizing a concept for export development, entrepreneurs are faced with a myriad of decisions. Among the most important is what type of company to create. In order to make that decision, the entrepreneur must determine what kinds of companies are recognized by national law (limited partnerships, associations, corporations etc.) and what different regulations apply to each. Options concerning capital formation, including the issuance

of shares, types of shares, rights of shareholders, and differential regulations governing debt v. equity, are all aspects of corporate law that have a bearing on the choice of entrepreneurs to establish export-oriented businesses.

Export business development depends on the transparency of these regulations. The subversion of existing corporate law by special interests amounts to a disincentive for potential entrepreneurs to create businesses. Therefore, whether legal requirements for incorporation of various types of businesses are simply guidelines for future negotiation with public officials or hard and fast standard rules is critical to measuring the costs of these requirements. Likewise, the complexity and variety of regulations governing various forms of private entities are fundamental. The more complex, the higher the costs of market entry for new businesses just to understand the options, and the less likely the development of rigorous competition.

Incentives for/against incorporation and registration. The more costly and complicated the process of incorporation the higher the costs of market entry. The potential pitfalls surrounding registration of businesses are similar to those surrounding registration of private and real property (see above). What are the rules governing incorporation and registration of companies? How transparent, and expensive, and complex is the process? What are the benefits connected with incorporation and registration in terms of security of property or trademark protection or access to government services or legal rights to dispute resolution or access to private and public financing? If corporate registration simply adds the name of a business to the tax rolls, what incentives exist to register? On the flip side of the coin, what penalties threaten to apply to those operating as a private business without having officially incorporated and/or registered?

The benefits of incorporation and of registration in terms of services and reduced costs to businesses must outweigh the costs in terms of time, effort, and tax liability in order for new entrants to incorporate and register. If costs outweigh benefits, entrepreneurs will migrate to the informal sector, with potential increases in inefficiency, loss of large market shares, and lost revenue to government coffers.

Limitations on alienation. Corporate law frequently restricts the extent to which corporate assets may be transferred to individuals or to other corporate entities. While some amount of restriction is appropriate to avoid the concealment of assets to avoid taxation or liability, the extent to which laws limit the rights of businesses to sell, lease or grant a security interest to creditors in corporate assets could well hamper the ability of potential exporters to conduct business in the international market. Fees, duties, and other taxes on the transfer of corporate assets should be measured against conventional practices among competitors.

Bankruptcy law. The extent to which companies fail in a competitive sense is dependent upon both the independence of the private sector and market competition. Regulations and rights relative to ending the life of a business may prove to be as important as those regarding its beginning, especially to investors and lenders. Corporate law which does not detail the rights and procedural options for business owners, investors, and lenders may dissuade export business development. Restrictions on the exit of failing enterprises were cited as a major problem in the

regulatory framework in Madagascar by the World Bank.[11] Ideally, bankruptcy law seeks to balance the interests of the debtor with those of creditors and seeks a predictable, efficient, fair and equitable resolution of disputes over the distribution of assets.

Procedures. In order to maximize efficiency, the efficacy of compromise and the certainty of outcomes, bankruptcy procedures, first and foremost, must be clear, must be standardized for every business, and must seek to minimize costs in terms both of actual fees (legal, filing, etc.) and lost time to creditors (the opportunity cost of outstanding liabilities). To the extent that procedures are not streamlined, the disbursement of assets could engender enough delays and disputes to discourage new entrants.

Securing the rights of creditors. Actual or perceived incidence of unorthodox transfers in the event of bankruptcy can also dissuade investment and lending to businesses. If bankruptcy laws do not nullify certain transfers for a period prior to filing (including both the settlement of debt to avoid preferential treatment of certain creditors and transfers to family members), the incentives for business owners to shelter assets from their creditors could be great enough to distort the loan market. For the same reasons, explicit definition of protection for secured creditors is a fundamental aspect of bankruptcy law.

Commercial law

Some of the aspects of commercial law to be examined in the context of developing countries are covered under the general section on contracts above. As is evident in the history of the development of commercial law in many common-law countries, general legal principles pertaining to many aspects of society emerged from the development of commercial law. Commercial law, here, is considered that body of business regulation that is written specifically toward the issues facing traders.

Baseline. In specific instances pertaining to international commerce, the baseline lies in such international conventions as the U.N. Convention on International Sale of Goods. This convention establishes a uniform law of commercial sales in international transactions and works to minimize uncertainty with respect to extra-contract liability, breach, and other areas of concern for many potential exporters.

Capital and current transactions. One area of particular concern is the extent to which transactions involving capital and current financial flows are subject to review, tax, or regulation by government authorities. Foreign purchase of assets (including but not limited to real property, as discussed above) is often restricted or forbidden by national laws in developing countries in order to limit the influence of outside parties in domestic affairs. The important role of foreign catalysts in the establishment and growth of export businesses, however, underscores the importance of enabling foreign capital investment, since the adoption of risk by foreign partners

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[11] World Bank. "Madagascar: Beyond Stabilization to Sustainable Growth." World Bank. Draft Photocopy. March 1991. p. 55.

greatly increases the chances that nascent export initiatives will succeed.[12] Inversely, restrictions on foreign purchase of assets have the potential to depress significantly private profits and tax flows from emerging export industries.

Extension to the informal sector. The extent to which positive law on contracts and sales applies to operators in the informal sector is a measure of the universality of that law as it is applied across segments of the society. When courts, whether commercial, administrative, or appellate, do not recognize members of the informal sector vis-à-vis contractual obligations, these parties are often forced to establish their own courts in the form of a parallel legal system, a solution that can prove extremely costly.[13]

Enforcement. In most respects, the problems that accrue to the formal and informal sector with respect to law on contracts and sales arise out of problems of enforceability and enforcement. What kinds of recourse exist for plaintiffs in contractual disputes? Is there a body of law that streamlines the litigation process, identifying a particular system of courts (commercial, administrative, or other) in which compensation or damages may be sought? What assumptions exist concerning torts? What jurisdictional provisions does the law contain when the defendant (or plaintiff) in a dispute is a foreign individual or corporation?

The answers to such questions are tantamount to the incentives for potential exporters to assume risk in writing contracts with domestic and foreign parties in the normal conduct of business. If options for recourse are unclear following a contractual dispute, or provisions for enforcement are inadequate (not only legal but also institutional and financial provisions), whatever other incentives exist for entrepreneurs to establish export industries are weakened as a consequence.

Finance regulation

Baseline. Regulation of financial markets in industrial countries conceptually presumes the existence of functioning financial markets, with demand for and supply of financial goods and services. In many developing countries, the financial sector is either just beginning to emerge as the result of privatization and a transition to a market economy, or, has not emerged at all. Therefore, finance regulation for the purposes of the methodology shall be defined in its broadest terms as those rules, implicit or explicit within the monetary policy regime, that govern access to finance of all types. Additionally, while securities regulation falls within this broad definition, the breadth and depth of securities markets in most African countries is so limited that the discussion here focuses on other credit sources. However, securities regulation will constitute a focus of study and analysis to the extent that it exists.

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[12] See, for example, Rhee, Yung Whee. *Trade Finance in Developing Countries*. World Bank Industry and Energy Department, Policy, Research, and External Affairs, Policy and Research Series No. 5. 1989; and Rhee, Yung Whee, and Therese Belot. *Export Catalysts in Low-Income Countries: A Review of Eleven Success Stories*. World Bank Discussion Paper No. 72. World Bank. 1990.

[13] de Soto, Hernando. The Other Path: *The Invisible Revolution in the Third World*. New York: Harper and Row. 1989. pp. 163-172.

Credit controls. Despite extensive policy reform in many countries, reform of the financial sector has occurred in a piecemeal fashion. The extent to which access of the private sector in Africa to commercial credit is controlled directly or indirectly by government has been a subject of recent study.[14] Credit controls are a direct function of the extent to which the government has permitted credit and interest rates to be governed by competitive markets rather than planners. Of special concern to exporters is the extent to which the government has implemented a system of currency valuation that is consistent with the monetary regime.

Duesenberry and McPherson comment that, despite significant economic reform, financial sector reform and a move to indirect credit controls in the sub-Saharan Africa region are particularly difficult. The reasons include a history of financial intervention by governments that retards reform, lack of confidence in the banking sector (after years of inflation and period devaluations), and the rents that accrue from financial controls, thereby increasing the direct costs of removing distortions.[15] The setting for reform faced by monetary authorities, therefore, "is characterized by deep-seated distrust and progressive institutional deterioration."[16]

For example, while several of the commercial banks in Madagascar have recently privatized, the amount of credit available to Malagasy entrepreneurs remains governed by credit ceilings imposed by the Central Bank rather than by competitive interest markets.[17] Although credit to the private sector increased steadily throughout the last half of the 1980s, credit was directed to the industrial sector at a far greater rate than to agriculture and services.[18] Small-scale entrepreneurs found access to commercial financing difficult. At the same time, despite successive devaluations that maintained the value of the Malagasy franc (FMg) at a level more or less equal to market rates, access to foreign exchange for importers was limited in the wake of a run on Central Bank reserves at the end of 1991, following the lifting of import restrictions.

In Ghana, where access to credit has been identified as a major constraint to development of the private sector, the squeeze is most apparent in the manufacturing sector.[19] Despite the establishment of a dual auction system for foreign exchange and a more competitive, market-based system for credit allocation, monetary programming remains hampered by problems in the estimation of balance of payments figures and inflation by the central government.[20]

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[14] Duesenberry, James S., and Malcolm McPherson. *Monetary Management in Sub-Saharan Africa: A Comparative Analysis*. CAER Discussion Paper No. 7. Harvard Institute for International Development. June 1991; and World Bank and USAID, 1991.

[15] Duesenberry and McPherson, 1991, p. 17.

[16] Ibid., p. 18.

[17] World Bank, 1991, pp. 41, 65.

[18] Ibid.

[19] Duesenberry and McPherson, 1991, pp. 42-43; Paul, 1990, pp. 25-26.

[20] Duesenberry and McPherson, 1991, pp. 42-43.

Capitalization and management. Embedded in the regime governing interest rates, of course, are other more general regulatory issues that have a direct impact on the private sector through the interest rate. What kind of standards must banks meet or seek in terms of "CAMEL": capital adequacy, asset quality, strength of management, earnings and liquidity?[21] How are banks supervised by central authorities? Are banks required to carry deposit insurance? What kinds of other financial services are banks permitted to market to the general public? What are the prevailing standards which define credit-worthiness? To what extent are bank records open to government or public scrutiny? In general, these questions all encompass an analysis of the costs faced by loan-granting institutions and the existing incentives to provide financing at a rate which will encourage exporters to borrow.

Interest rates may not be denominated in traditional financial terms. In countries governed by Islamic law, for instance, explicit charging of interest by even commercial financial institutions may be deemed illegal since it violates traditional Sharia law against usury. Interest rates, in this case, may be figured on the basis of a share in any profits which accrue to the borrower or in some other form of "interest" in equity terms. The form that interest rates take, therefore, may be less important than the transparency, competitiveness, and even-handedness with which rates are determined.

Procedures. Even lending systems considered quite developed in terms of the plethora of available instruments and market-driven rates of interest can levy high transactions costs if the procedures required to obtain financing are unduly burdensome. Part of the success of the Korean system of letters of credit (L/Cs), for example, lies in the speed and ease with which L/Cs were made available to firms which could furnish the export order. The costs of borrowing, therefore, must be measured not only in financial but economic terms. The recurrent costs of time, personnel and capital required to obtain credit on an ongoing basis may prove too high for firms to borrow and invest in export-oriented enterprise. Minimizing the procedures required for each loan, or streamlining the process to enable eligible enterprises to qualify for recurrent financing only once is clearly in the best interests of private sector efficiency.

Foreclosure. Even where markets determine interest rates and regulations surrounding collateral are clear and equitable, the procedures and costs of the enforcement of contracts, in this case foreclosure, may pose a potential barrier to lenders and creditors alike. The transparency of the system in terms of foreclosure is one aspect of increasing borrower confidence in the financial sector. What rules define adequate notice of imminent foreclosure? What uncollateralized assets might be seized and on what basis will they be valued against the borrower's remaining liability? Setting aside issues surrounding the resolution of disputes (treated elsewhere), what legal standards apply to the process of foreclosure and do they effectively reduce its costs? Who bears those costs? More important at times than the costs of foreclosure are the potential benefits and to whom the proceeds of foreclosure usually accrue. If parties other than the creditor and debtor (and their representatives), such as government agencies or institutions, become involved at the advent of foreclosure, what interests and power do they hold over the process, its initiation and its closure?

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[21] Duesenberry and McPherson, 1991.

Regulation of competition

The tradition of public monopolies in many African countries renders rather moot a full discussion of regulation of competition in the region. In the move toward privatization and dismantling of public marketing boards, there may be an unmet need for the development of laws pertaining to trust, price-fixing, oligopoly, monopoly, and other manifestations of lack of competition within the private sector.

Baseline. Because of the varying degrees of transition across developing countries with respect to privatization and market reform, the clear identification of a standard against which to measure the efficacy of competition law is problematic. Additionally, the traditions of anti-trust legal development among even former colonial powers falls across a broad range of historical experience and many industrial countries continue to question the role of public companies, the appropriateness of deregulation and competition in the provision of certain basic services, and many other fundamental questions.

The efficacy of monopoly conditions in certain industries or sectors is not an issue with which this paper is concerned. It is assumed that nontraditional export industries will operate most efficiently under competitive conditions. The baseline, therefore, should be defined loosely as the ability of new firms specializing in nontraditional exports to enter the market and have the opportunity to compete. What is the legal structure that derives from monopolist or oligopolist traditions and that effectively blocks new entrants to a sector or industry?

Marketing boards. Many developing countries have relied historically on marketing boards and price controls to smooth the variations in the international business cycle for small and medium-sized producers of tradables. The distortions and inequities which result from such control of the market by government agencies are legendary and well documented. The process of structural adjustment seeks to eliminate such distortions and has contributed to the successful dismantling of many of the parastatals and price controls that prevailed throughout the 1950s, 1960s and 1970s.

Remnants of these controls may remain, however. For example, regulatory power over private sector export-oriented industry in Ghana, a country heralded as a model of successful adjustment, resides with the appropriate ministries, the National Revenue Centre and the Bank of Ghana, the Ghana Investments Centre, the Registrar General of Ghana, the Tripartite Committees on Wages and Salaries and the Prices and Incomes Board. While the control that these latter public agencies maintain may be minimal, their potential regulatory impact is not costless and must be measured against the services they provide to the private sector.[22]

Privatization. Included in this category of law are those statutes and regulations governing the sale of state-owned enterprises to the private sector. Since the development of these regulations and statutes often unfolded in response to a particular industry or legal dilemma, the body of law may prove to be rather distorted when applied more generally to the public and private sectors. In particular, potential conflicts of interest may be embodied in privatization

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[22] Paul, 1990, p. 32.

laws which do not prevent the simple continuance of a public enterprise, with all of its prior inefficiencies and bureaucracies under new title. Privatization law ought to ensure that not only are the assets of a particular concern transferred to private interests, but also that competitors within the same industry may emerge and have access to contracts, supplies, credit, and other resources along lines similar to the former public monopoly.

Environmental regulation

The advent of environmental regulation is a welcome development in many countries. Whether geared to Western precepts of a polluter-pays principle, or designed to protect the natural resource base through specific restrictions on use in the interests of conservation and preservation, environmental law is often broad and far-reaching by design. It pertains to land use, resource rights, mitigation liability and can often appear quite byzantine in its configuration around specific interests and problems.

Baseline. Given the complexity and broad scope of much environmental regulation, the baseline for the purposes of this methodology shall consist of those international conventions and agreements which specify an international standard on particular environmental issues, whether or not a particular country is a signatory. An incomplete list of such conventions would include the Convention on International Trade of Endangered Species (CITES), the Montreal Protocol on Substances that Deplete the Ozone Layer, the International Tropical Timber Agreement (ITTA), and the United Nations Conference on Environment and Development (UNCED) accords on forestry and principles of development.

In most country cases, environmental regulation is likely to be minimal and pertinent only to a few key resources or industries. Where national environmental law is not relevant to these international standards, it should be measured by the extent to which it encourages private firms and individuals to internalize the social costs of production.

Access to public resources. A key element in the economic development of all countries and the profitability of the private sector is access by individuals and firms to public resources. Whether as a source of free industrial inputs, or as a sink for waste, the natural resource base in virtually all developing countries suffers a significant free-rider problem stemming primarily from legal status as an open-access resource. Forests, water resources, and wildlife stocks have traditionally been mined beyond their regenerative capacity as populations increase and demand for land and food expands. While not explicitly a form of environmental regulation, the legal traditions and constitutional rights underlying customary resource access should constitute a focus of analysis. Such a focus is especially important given the linkages between access to resources and the short- and long-term cost structures of emerging nontraditional export firms.

Labor law

Most sub-Saharan African countries share one common comparative advantage in international business. The supply of skilled and unskilled labor is high relative to Asia and Latin America. The cost of labor relative to other inputs, therefore, is relatively low. This

economic reality poses a dilemma for export business owners and lawmakers alike. Laws and regulations governing labor must seek a balance between, on the one hand, adequate protection for the worker in terms of health, safety and compensation, both for reasons of basic human rights and to preserve access to international markets, and, on the other hand, preservation of comparative advantage represented in low wage rates.

Baseline. The baseline for labor law lies in internationally accepted standards embodied in the conventions signed under the auspices of the International Labor Organization (ILO) and/or the E.C. Generalized System of Preferences (GSP)[23] since these have a direct bearing on the ability of exporters to operate within the international marketplace. For conditions or regulations not clearly covered by the ILO or GSP, the baseline may be identified in standards articulated under the auspices of the Lomé Conventions (Lomé IV was signed in December 1989) and any other international agreements to which an individual country is a signatory. As is the case with many aspects of the Lomé Conventions, certain provisions relative to labor law in the Lomé agreement may supersede obligations under the GSP of a trading partner or some other agreement.

The obligations and responsibilities of employers to meet minimum standards are governed not only by agreements signed by governments but by minimum requirements of the governments of those countries representing potential markets. Employers must have ready access to the laws and regulations detailing obligations regarding labor practices under both national and international law. In addition, exporters face conflicts between the national laws of a signatory country and international standards required of that country by virtue of being a signatory to a particular convention. While the short-term financial incentive may be to behave according to the standard most likely to be enforced locally, exporters in such circumstances are ultimately accountable to a higher standard within the international marketplace. The greater the differences between national and international standards, the greater the dilemma.

Workers' rights. In general, international agreements that detail minimum labor law requirements base those requirements on the concept of workers' rights. The ILO, for example, through various conventions, requires that signatory countries establish minimum standards detailing the rights of workers with respect to free association (ILO Convention No. 87), organization and collective bargaining (ILO Convention No. 98), forced labor (ILO Convention Nos. 29 and 105), minimum age of employment (ILO Convention No. 138), occupational safety (ILO Convention Nos. 148 and 155), and exposure to toxicity in the workplace including radiation (ILO Convention No. 115), benzine (ILO Convention No. 136) and cancer-causing agents (ILO Convention No. 139).

Workers' compensation. National laws frequently establish minimum wage rules and other regulations governing compensation for overtime and additional benefits. Benefits regulations may be brief in developing countries, but, more importantly, they may be too vague to establish a clear standard for worker protection. Benefits laws may address health insurance,

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[23] The EC GSP was chosen as opposed to the US GSP or the GSP of another country because of the much larger portion of existing trade between African countries and the EC in comparison to African trade with other markets. Where appropriate, the relevant GSP should prevail.

workers' compensation for time lost due to illness or injury, severance pay and retirement benefits.

The key to analysis of compensation regulations is the extent to which the laws force companies to become uncompetitive relative to their international counterparts. While ILO standards can form the base against which health and safety regulations are measured, as well as standards regarding access to health and retirement benefits, the ILO cannot speak to the extent to which laws governing wages in local currency unfairly penalize exporting businesses in terms of their competitiveness abroad. Ideally, the extent to which changes in real wages parallel changes in productivity would provide the best measure of both wage fairness and competitiveness. However, data regarding productivity trends in developing countries remain largely unavailable, especially in sub-Saharan Africa.

One alternative measure of judging the suitability of wages is by comparing trends of domestic wages measured in local currency, denominated in foreign exchange (to reflect the impact of devaluations on real wages), and deflated by the CPI. For example, Mauritius legislated wage increases between 1980 and 1990 that surpassed both increases in wages denominated in foreign exchange and increases in the CPI (Figure 1). With 100 as the benchmark in 1980, the wage index in local currency had surpassed 300 by 1990, whereas the index of wages in French francs initially rose above local currency wages (since nominal devaluation vis-à-vis the French franc did not occur until the mid-1980s) but had leveled off by 1990 at approximately 200. The wage index divided by the CPI for each period also rose throughout the decade, but at a much lower rate, settling in 1990 at approximately 130.[24]

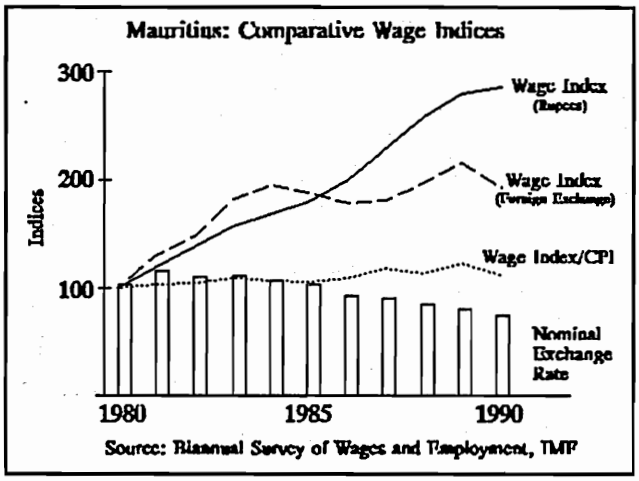

Figure 1

Such a comparison yields very useful information concerning the trends in real labor costs to exporters and the extent to which they can remain competitive despite variable rates of inflation and changes in the value of local currency. The nominal wage rate in the 1980s in Mauritius would seem to have placed exporters at a significant disadvantage in the international marketplace. However, given the economic impact of inflation on wages, real wages increased at a far lower rate. Therefore, the impact of legislated wage increases in Mauritius was far less in terms of international competitiveness than is apparent by looking only at an index of nominal wages in rupees.

[24] The data for this example are taken from World Bank, *Mauritius, Expanding Horizons, A World Bank Country Study*, 1992: 12 *et seg.*.

Foreign workers and managers. The labor codes governing the eligibility of foreign workers and managers can have an adverse impact on the ability of local firms to compete effectively in the global marketplace. Labor codes of developing countries often restrict the hiring of foreign workers by local firms (and foreign firms for that matter) in an effort to guard against the loss of employment opportunities for nationals. If foreign workers cannot be employed by domestic firms, or if their employment opportunities are limited numerically or in terms of duration through visas and work permits, the ability of local firms to gain from foreign expertise can be severely diminished. If such restrictions exist, their impact on the hiring practices of potential exporters must be measured against what would be the case in an labor market unrestricted as to the nationality of workers and managers.

Foreign partners (or "catalysts") for export development have played a particularly important role in designing and managing production systems and training local workers to operate productively within them.[25] Restrictions on the hiring of foreign workers, therefore, may prove to be particularly counterproductive if they hamper the ability of local firms to train their employees in special skills required for export development, such as assurance of quality standards in manufacturing and transportation.

Labor administration and enforcement. Even if exporters were to face labor laws perfectly in tune with international standards, the inability of government agencies to enforce these laws could inhibit export development. Low budgetary resources, unfamiliarity with the demands of regulating a burgeoning private sector and lack of available sanctions in the law could encourage the private sector to ignore their legal obligations regarding labor and could thereby risk international trade retaliation against exporters.

Exporters may also face costs associated with highly efficient labor administration and enforcement if the underlying costs prove unduly burdensome. Since labor costs are often the largest component of total costs, a labor code which specifies minimum wages, benefits, and, especially, job security, may inflate the cost of labor far above the costs faced by international competitors, rendering the business uncompetitive.

The written law may differ substantially from common practice, especially in countries with extensive unemployment or underemployment. Therefore, common labor practices within both the private and public sectors will also be studied.

Intellectual property ownership (patents, trade marks, copyrights, etc.)

Baseline. The baseline with respect to the legal regime governing patents, trade marks, copyrights, and trade secrets lies in internationally accepted practice. These norms are clearly codified in several international conventions. Two key conventions governing patents are the U.S. Model Annex Agreement Concerning the Protection and Enforcement of Intellectual Property Rights (hereafter referred to as the "US IP Agreement") and the draft Agreement on Trade Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods (hereafter,

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[25] Rhee and Belot, 1990.

"TRIPS"). Both require compliance with the Paris Convention of 1883. International conventions pertaining to copyright protection include the Universal Copyright Convention and the Berne Convention, as well as the two conventions noted above. Whether a country has acceded to these international conventions should largely dictate the extent to which their internal legal regimes are consistent with international norms.

The goal of protection law in any one country should be to ensure the rights of patent and copyright holders abroad, whose products are imported, as well as inventors of intellectual property at home. Inadequate protection of either sort could dissuade potential exporters from obtaining the industrial processes, software and other intellectual property required to take best advantage of market opportunities.

Definition of protected material and exclusions. Among the first questions to be posed is what exclusions from protection are codified in the relevant laws. National (and international) standards based on ethics and concepts of the common good prevent inventors of certain kinds of goods and processes from profiting from their ideas. Examples include scientific and mathematical theories, medical procedures, and, in some cases, certain types of living organisms. Countries run the risk, however, of stifling invention and entrepreneurship by identifying a broad range of broadly defined items and concepts which are excluded from patentability or run counter to specific cultural norms.

Terms and procedures of protection. The length and variability of time periods for patent protection specified by existing law is also a potential source of problems for entrepreneurs in intellectual property. If the period of protection is too short, protection can be effectively nullified given the lags inherent in development of foreign markets and sources of supply, especially for entrepreneurs in countries not internationally recognized as technology exporters. To the extent that procedures for obtaining protection differ from international norms, potential creators of intellectual property will have a disincentive to seek protection through patents. Requirements governing the establishment of novelty and utility may well be codified and consistent with international norms, but may not articulate conditions of reciprocity with other countries in terms of effective dates of onset of protection after patent filing or trademark registration.

Right to assign. As with other types of property rights, the transferability of patent rights is as important to clarify as the definition of those rights. Should a foreign collaborator, whether an individual or a corporation, seek to transfer patent ownership, or an interest in that ownership (in the form, for example, of a percentage of royalties and infringement rewards) to an individual or corporation in country, will the receiver qualify for the same protection under local and international law as the assigner? In all likelihood, if the law articulates assignment rights, it probably allows for full assignment of all protection emanating from those rights. The potential costs, therefore, lie in the absence of such a stipulation in the patent law and the uncertainty which arises should protection be challenged after assignment.

Technology transfer. Many of the legal and economic principles governing the desirability of protection of intellectual property pertain to property that is imported as well as to property that originates within national boundaries. Developing countries, especially, are eager to encourage technology transfer. However, in order to assist potential exporters in obtaining

appropriate technological inputs as well as to protect them from international retaliation, it is necessary to examine the extent to which rules governing technology transfer adequately protect the technology from duplication once it has entered the country.

At least three potential problem areas deserve mention here. First, encouraging technology transfer requires that licensing restrictions be lifted. Potential users of importable technology need to be able to gain access to user licensing without an unwieldy qualification process. Likewise, ensuring that technology, once transferred, enjoys adequate protection requires that users have access to foreign exchange with which to pay royalties. Therefore, if foreign exchange is not readily accessible due to credit controls by the central bank, potential exporters may receive special dispensation to qualify for access to foreign exchange to enable them to obtain technology according to internationally accepted norms. Finally, states can encourage more technology transfer as well as payment of all royalties to foreign patent or trademark holders through reduction or elimination of tax liability on payments abroad. At a minimum, tax rates on royalty payments should be consistent regardless of whether the holder of the patent is foreign or domestic.

Foreign Investment

As a topic, foreign investment falls into a category of its own for two reasons. First, the issues pertaining to foreign investment are identical to those surrounding domestic investment and therefore the topic does not fall neatly under any one category. All of the issues discussed above apply equally whether the private sector is foreign or domestically based. To the extent that business laws and regulations provide necessary conditions to encourage productive domestic investment, they will encourage foreign investment as well. The distinction drawn is notably a hollow one.

Many developing countries, however, have treated foreign investment as a very separate dynamic in economic development and, in many cases, have created a parallel legal regime pertaining to foreign investment alone, effectively subverting domestic regulation in order to attract or control investment from abroad. The second reason for separate discussion of foreign investment lies, therefore, in the fact that continued institutional barriers often favor either foreign or domestic investment.

The climate for foreign investment is a function of many different factors including patterns of past foreign investment, political and economic conditions and laws and regulations governing investment by entities which are headquartered outside national boundaries or which are wholly or partially owned by non-nationals. Ideally, these factors are mutually reinforcing. However, in developing countries, this is frequently not the case. If economic conditions--in sub-Saharan Africa's case, a comparative advantage in labor-intensive products--prove attractive to foreign investors, political conditions may deter them. Likewise, if a number of special incentives have been created in order to attract investment in a particular sector or zone, but the return on past investment has been poor, then these incentives may not be sufficient to overcome the resulting uncertainty.

This study is concerned especially with the rules that apply to investment by foreign concerns. Clearly, certain restrictions on foreign investment are justifiable for reasons of national security, national sovereignty, and efficiency, including defense, utilities, and transportation infrastructure (e.g. ports). The baseline against which a country's foreign investment regulations is measured is the minimum required for the protection of national security interests.[26] Other restrictions, be they sectoral, quantitative or procedural, may impede the establishment of joint ventures and other types of partnerships that could have a strong beneficial impact on the national economy. Even where a country interested in promoting nontraditional export growth removes legal barriers to certain industries or sectors, the potential for unforeseen export growth in other sectors makes it highly desirable to avoid such barriers wherever possible.

Restrictions. Restrictions on foreign investment in certain sectors can severely limit the ability of potential exporters to operate in the international market. For example, limitations on the ability of foreign financial institutions to participate fully in the economy could preclude the ability of a firm to obtain insurance or loan guarantees with the full backing of a foreign corporation, unnecessarily limiting export volume. Where non-financial services are reserved for ownership and operation by nationals, this restricts competition and the development of an international standard against which national firms can compete effectively in both the domestic and international markets.

Licensing and/or public agency approvals of certain kinds of equity holdings by foreigners may also impede efficient business practice if the approvals are granted on a discretionary or less than transparent basis. In addition to creating incentives for rent-seeking behavior on the part of public officials, such approval processes run the risk of deterring those investors who fear license or approval revocation. For example, in Chad, the approval processes for qualification for benefits under the Investment Code (for domestic as well as foreign businesses) involve an *agrément* between the state and the firm according to whether the firm falls into one of four categories, and meets various conditions under each one. The standards are judged to be prejudicial and unduly burdensome for small and medium-sized enterprises.[27]

Another common focus of foreign investment law sets minimum limits on the amount of equity that can be held by non-nationals. In general, international standards should apply and should balance security interests with economic interests. In those industries that could clearly benefit from foreign influence and equity capital but that traditionally have been treated as important to the national interest, some restriction on foreign ownership may be appropriate. Broadcasting is a good example. While many countries restrict the extent to which broadcasting companies can be controlled by non-nationals, some foreign investment for the purposes of acquiring technology or expertise may be in the interests of producers and consumers alike.

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[26] This kind of baseline necessarily requires a qualitative judgement, but one that is informed by international convention. Utilities, for example, are commonly best managed as public, regulated monopolies (given the alternatives) whereas the history of Central Europe and the nations of the former Soviet Union indicate that industrial manufacturing concerns are more efficient if managed privately.

[27] Aucoin, 1992, pp. 55-56.

Incentives. More common than explicit restrictions are targeted incentives created by national laws in order to encourage foreign investment in certain industries or sectors. The potential effect of investment incentives must be measured not only in terms of the benefits accruing to specific those industries being encouraged but also to sectors or industries that may fall outside the purview of the investment incentive package but nevertheless hold strong potential benefits for local entrepreneurs as well as foreign investors. In general, a plethora of investment incentives implies *de facto* that exceptions must be made for a large number of restrictions. Dismantling the restrictions themselves can prove to be far more cost-effective and efficient than creating successive loopholes, since the complete removal of barriers intrinsically streamlines the investment process, reduces transaction costs for investors and opens export opportunities in sectors that might be profitable but were not previously eligible for special exemption.

Incentives to foreign investment discussed here are exclusive of those explicitly related to trade through free trade zones, since they are discussed below, although many of the same principles and problems characterize both incentive regimes.

Fiscal incentives. Among the most prevalent type of incentives offered to foreign investors are tax holidays. Countries offer periods of forgiveness of corporate income tax or some other liability for some initial period in order to lure foreign investment, especially by multinational companies. Many of the incentive packages can backfire, however, in that they fail to act as an incentive and merely direct tax revenues into the treasuries of the companies' home governments. This occurs as a result of the concept of "global" income applied in some countries (France is a notable and relevant exception) to firms based within their borders but operating internationally. Such countries tax firms on all income earned everywhere, and taxes paid abroad may often be credited in full or in part against the home tax liability. When developing countries create tax holidays for companies based in such countries, the total tax liability of the corporation does not change, since the home tax liability increases accordingly. Tax holidays can therefore deflect revenue from the host state to foreign treasuries.

An additional potential problem with fiscal incentives to foreign investment is that countries often cannot afford to sustain them. Firms attracted to a given country set up local operations because the net present value of their investment is positive. Reduction of tax liability rarely tips the balance of the profitability equation, and yet the tax revenues from foreign companies, especially large multinationals, can represent a significant share of a government budget. Foregoing that revenue may be impossible in light of the extra government services required to support incoming business.

When is a tax incentive appropriate? Clearly many tax benefits are cost-effective for national governments to offer, but to be cost-effective they must capitalize on a country's comparative advantage within and across sectors and prove to be at least revenue neutral in balancing additional costs with foregone taxes. In general, the less discretionary and the more broadly applicable a fiscal incentive is to potential investors, the more effective it will be in attracting investors seeking to place capital in foreign production and services.

Remittances. A major concern for foreign investors is the extent to which profits may be repatriated. While many countries place restrictions on capital movements, exceptions are often made in the case of corporate profits in order to attract foreign investment. Quite apart

from complications involved in trading of foreign exchange, businesses and individuals may be required to pay unusually high withholding taxes on dividends and other profit distributions. To the extent that a country's rules applicable to repatriation of business profits and investment income reduce the comparative advantage of doing business within its borders, potential investors will seek to invest elsewhere.

"One stop shop." Many countries are attempting to overcome the complexities of foreign investment by creating a single window for investment information and approvals from national governments. Designed to reduce transaction costs for investors (both foreign and domestic), the single window concept provides efficient access to the relevant laws and regulations. Admittedly, the concentration of services, in the worst-case scenario, can threaten to compound the costs and bureaucratic delays associated with investment, especially if one agency is given discretionary power over an investment approval process. However, in most cases, the single windows are limited to providing information and guidance and can serve to expedite foreign direct investment considerably.

Investment treaties. Another potentially useful device is the BIT (bilateral investment treaty). Such treaties most often seek to streamline regulation and tax liability on companies and individuals investing between two countries through negotiation of reciprocal treatment. The advantage of such treaties is that they can be used to formalize a traditional (or growing) trade relationship and strengthen political and economic ties, thereby benefiting both signatories. When BITs are formed in order to exclude third parties, however, or meet politically driven goals, or when they coalesce in conflict with existing multilateral obligations for one or both parties, they can contribute significantly to a climate of uncertainty for emerging export-oriented businesses.

Branches and subsidiaries of foreign companies. Many countries distinguish among domestic companies, branches of foreign companies (wholly owned abroad) and subsidiaries of foreign companies owned in part or totally by nationals. Given the importance of interaction with foreign catalysts of export industries, the extent to which these distinctions affect the costs of doing business can fundamentally alter the chances for successful export development.[28] In general, the less that national laws distinguish between domestic and foreign ownership, and the less that the activities of foreign partners are regulated, the more likely it is that foreign companies will invest in and support the development of nontraditional exports.

The following areas all constitute likely areas for study with respect to the treatment of branches and subsidiaries of foreign companies:

1. minimum requirements for proportion of domestic ownership;

2. approval process for the writing of contracts between foreign and domestic entities;

3. tax treatment;

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[28] Rhee *et al.*, 1984; Rhee and Belot, 1990; World Bank and USAID, 1991.

4. profit repatriation to foreign headquarters;

5. minimum requirements with respect to use of local inputs;

6. minimum (or maximum) requirements with respect to proportion of production exported.

In each of these areas, national laws can inhibit the involvement of foreign companies and generate disincentives for the establishment of foreign/domestic relationships. In some of these areas, the tradition among especially sub-Saharan countries has been to seek legal means to limit foreign involvement in domestic affairs. This has been especially true with respect to foreign ownership of domestic industry and profit repatriation by a subsidiary or branch of a foreign company.

Expropriation. One special issue deserves mention which falls outside the realm of regulation and more in the area of past investment history mentioned above as a factor determining foreign investment. The history of many developing countries both within and outside of Africa has included the successful courting of foreign direct investment only to be followed by a change in ideology or power and the "nationalization" of private property. As a concern of investors, the possibility of expropriation falls outside of the realm of property rights since a single decree or *arrêté* can supersede all existing laws and regulations. While the right of the state to seize property within its borders may be permissible constitutionally (under a proclaimed state of emergency, for example, or for purposes of national security), the fact is that property has been seized in several countries of Africa, Asia and Latin America on the basis of a change in regime and the suspension of the constitution rather than through due process.

Clearly, the possibility of expropriation is a significant deterrent to foreign investment. A history of expropriation or constitutional provisions defining the terms for expropriation should be examined carefully for the possible impact on future investment. Assurances of compensation that is "just" (e.g. market value) or other measures (such as a bilateral investment treaty) to minimize the uncertainty in this regard may be an essential component to a successful investment incentive package.

Business Regulation Pertaining to Public/Private Sector Interface

Taxation[29]

For the purposes of examining institutional constraints to nontraditional export growth, taxation shall be considered in terms both of potential undertaxation and overtaxation, both of which distort the costs of business and engender inefficiency. Therefore, the tax (and subsidy) regime and its effects will be measured by the extent to which it alters the costs of doing business for an exporting firm as compared to the firm's international competition.

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[29] "Taxation" here includes all of the taxes and subsidies which the private sector faces. Import and export tariffs, as a special subset of taxation, are considered separately below under the category of international trade.

Governments seek revenue at any number of points along the chain of export production and processing. Taxes may be levied on inputs, semi-finished and finished products leaving the factory, transportation, shipping inventories, at the border or exclusively on income of shareholders. The combination of potential tax liabilities and their cumulative financial impact constitutes an important part of the total incentive package that exporters face. The choice among levies by government policymakers can also have a direct impact on the propensity of the private sector to export. Even among those countries that have liberalized their tariff regimes, many have yet to determine the optimal form of taxation in terms either of revenue generation or of export development.

We shall assume that some form of taxation is appropriate to underwrite the provision of fundamental government services to the private sector, including development of transportation infrastructure, provision of utilities, supplying of market information, etc. If that is the case, then the goal of tax policy should be to minimize the marginal cost to the private sector of generating a given amount of revenue for the provision of those services. The general trend is to consider a value-added tax (VAT) the most efficient in these terms. Levied on a standard *ad valorem*, or percentage, basis, the VAT serves as a simple, straightforward method of generating revenue without creating a disincentive to produce or export. Other forms of taxation on corporate income or investment, for example, tend to be less effective. Not only do such taxes generate a small share of additional revenue but they also create incentives to hide financial flows and can tip the scale against an economically optimal mix of factors of production.

Equally important are 1) the collection rate and 2) the extent of tax holidays awarded to certain firms or sectors. If actual collection of corporate taxes occurs at a relatively low rate, it is important to investigate the reasons. Whether the source of a poor collection rate is lack of public resources for tax collection or evasion by liable firms says a great deal about the nature of tax enforcement and the incentives for new business entrants to operate along standard legal terms. Likewise, if competing firms receive some sort of tax holiday on the basis of what they produce or where they produce it or who they are, it is essential for the government to reveal the nature and rationale of these exceptions or risk losing new entrants.

International trade

By definition, the countries considered good candidates for an examination of the institutional constraints to nontraditional export growth have undertaken structural adjustment. Often the economic reform process includes reduction or elimination of explicit trade barriers including tariffs and quantitative restrictions on imports and exports. However, since the focus of this reform is also often on the traditional trading sectors and may be limited initially to certain commodities and industries, barriers linger that impede especially the ability of entrepreneurs to develop new tradeables.

Baseline. The baseline for measuring the impact of the remaining tariff regime is the same international agreements pertaining to trade that determine the international standards in other legal areas, including those falling under the auspices of GATT, the Lomé Conventions, and other regional conventions to which specific countries are signatories.

Tariffs. Despite the fact that many countries have successfully converted quantitative restrictions into tariffs, many trade distortions still remain. The levels of tariffs are key to determining incentives facing exporters as well as importers. First, tariffs paid on imported inputs raise an exporter's cost relative to the cost of overseas competitors. Second, tariff protection of import-competing industries attracts labor, capital and other resources to those industries, increasing the cost of these resources to the exporter. Finally, import tariffs and quantitative restrictions result in an overvalued exchange rate that penalizes the exporter in relation to the nontradable goods sector. Where export taxes exist, of course, they also act as a disincentive for exports.

In order to promote exports or production of certain products, many governments have instituted drawback or exemption schemes. Typically, these allow producers meeting certain criteria to apply for reimbursement of tariffs paid on exports or imported inputs (drawback), or permit the producer to be exempted from certain tariff liabilities altogether. The potential problem with drawbacks and exemptions lies both in the criteria required to qualify for special treatment and in the fair and even application of those criteria to all qualifying firms. If the criteria are too narrow, too industry-specific or exclude certain sectors or commodities from taking advantage of the incentives, potential exporters could be hurt. Likewise, if the criteria are broad but unevenly applied, awarded discretely to certain producers and not others without clear differences, or require lengthy and complicated bureaucratic procedures, they prevent the incentives from accomplishing their intended goal.

Another problem arises when imported inputs are not used directly by the exporting firm but in the production of an intermediate good that is supplied to that firm. Ideally, duty drawback and exemption schemes should apply to imported inputs that are used either directly or indirectly in the production of goods to be exported, In fact, the record-keeping and efficient administration required for these incentives to apply to indirect imported inputs are usually too great to allow them to be offered in most African countries.

The administration of tariff regimes may also constitute a net incentive or disincentive to do business for potential exporters. When the method of classification of products subject to tariffs, in itself, is not in accord with international convention, transaction costs increase for potential exporters who must then reconcile and decipher conflicts of interpretation.

Another common administrative pitfall occurs in valuation of products. One valuation issue lies in whether a tariff is calculated on an absolute or *ad valorem* basis. The latter is clearly the standard in international transactions since it does not distort incentives among producers of competitive products. Additionally, there are frequently disparities even within countries with respect to the determination of the base value of a product for tariff purposes. Many trading countries ascribe to the Brussels Definition of Value, which seeks to value products at the price they would command under perfectly competitive market conditions. Since objective market information is far from perfect for officials and producers alike in developing regions, adopting this standard can prove to be burdensome. National and regional trading associations can play an important role in creating and maintaining data banks for this purpose.

While reference has been made to the importance of maximizing the efficiency of whatever customs procedures are in place, a significant lack of administrative resources often

prevents customs officials from performing their appointed tasks. Adequate inspection and duty collection is essential in order to avoid incentives for rent-seeking both by officials and individuals in the private sector. Standard lengthy delays, unclear regulations, untrained personnel, lack of communications equipment and general inefficiency can negate the potential benefits of the most open customs regime, compounding the constraints to export growth.

Quantitative and qualitative restrictions. Both quantitative and qualitative restrictions can potentially affect the profitability and incentive structure of export producers. While many countries have dissembled quantitative restrictions on trade, including licensing procedures, prohibitions and quotas because of the market distortions which result, qualitative restrictions are often sought out as a method of ensuring marketability and building a national reputation.

The persistence of quotas on imports and exports results in the same type of inefficiencies and distortions as tariffs. Quotas generate an additional disincentive for potential exporters in that licenses to import or export are distributed, often free of charge, to a limited number of businesses. The result is that rents are direct, in the form of additional profits to those who obtain necessary licensing for key inputs, or access to export shares. The extent to which lingering quantitative restrictions on both imports and exports create an unfair playing field must be measured in terms of their cost to new market entrants.

Product standards are one form of qualitative restriction that prove to be more controversial. The desirability of such restrictions depends in large part on their purpose. For example, prohibitions on the export of certain unprocessed foods for reasons of meeting minimum international standards of health and sanitation are clearly desirable for reasons of marketability. A national legal authority may justifiably impose restrictions in order to build and protect the reputation of an exporting country in the marketplace, especially of that country is not known as an exporter of a given product. Fruit exporters in Chile felt the impact for years of a fatal prank in the mid-1980s which tainted a few Chilean grapes consumed abroad. Not only was the market for grapes affected, but all Chilean fruit became suspect for some consumers fearful that quality standards in Chile were routinely unenforced. A good argument can be made not only for qualitative restrictions in terms of health and sanitation but also in terms of maximizing value added for any export. One potentially useful role for national governments is in not only ensuring that health and safety standards are met but also in distributing market information on quality standards in target market regions of the world and the effect of those standards on the price those products command. Standards may, on the other hand, be unnecessarily restrictive and fail to allow for substantial quality variation among overseas markets.

Product standards that are not market-driven can also prove to be detrimental. Countries sometimes impose restraints on certain types of exports to retain a given share for domestic consumption, or to assist in the propping up of a national cartel or trading association. In general, such laws unnecessarily distort the market and discourage export growth. To differentiate between potentially positive and negative qualitative restrictions, it is necessary to examine the requirements and benefits of membership in trading associations and whether their formal ties to government afford them any unfair advantage. It is ironic that public marketing boards and parastatals are often considered to be inefficient while trading associations, which have the potential to prolong many of the same inefficiencies, are being heralded as critical to effective marketing abroad. Questions should be posed concerning the openness of membership,

the access to concessionary financing or foreign exchange afforded to members, the types of overhead costs reduced through the association and the freedom of information provided.

Finally, many of the same constraints arising from tariff administration can arise from administration of quantitative and qualitative restrictions on trade. Problems pursuant to methods of product classification, to procedural inefficiency, discretionary authority and potential rent-seeking all pertain to trade regimes reliant on quotas, prohibitions and licensing.

Free trade zones. In order to promote exports, many countries have instituted free trade zones (FTZs). Incentives for export production within a FTZ can include avoidance of import and export duties, access to licensing and concessional financing, access to global market information and contact with foreign partners, all of which have proven to be key factors in successful export promotion schemes in the past.[30]

Given that in a perfectly free market, an entire country (indeed the whole world) would constitute an FTZ, it is important to note that the relative success of an FTZ in changing trade patterns and increasing profits is, first and foremost, a measure of the prevailing distortion in the larger economy. Nevertheless, many of the incentives created under the rubric of the FTZ represent strong and positive steps toward real economic growth.

The administration of FTZs can be fraught with the same dangers as administration of a customs regime. Preferential treatment for approvals, lack of training of the managers of the Zone and incentives for rent-seeking all may result. However, many of the administrative problems can be avoided if the criteria for operating within an FTZ are clear and fair.

Bonding is an administrative device common to export promotion in general and FTZs in particular. Bonding refers to the guaranteeing that a certain stock of goods is destined for export or as an input into the production of exports, and therefore qualifies for reduced taxation or total exemption from import or export duties. Legislation defining bonding procedures can stipulate that individual factories, warehouses, or other industrial sites are bonded, meaning that a bank and/or some other guarantor is prepared to provide proof that inventories of inputs or finished goods do meet the required specifications for duty exemption and, further, that back-up information concerning volume and value of inventories may be furnished to customs inspectors. The ultimate goal of bonding is the reduction of transaction costs through the streamlining of procedures concerning the flow of certain types of goods. Bonding systems that work well frequently require minimal paperwork and expedite the shipment of all relevant goods and information. Problems can arise even in the most successful of bonding systems, however. In Mauritius, for example, bonded factories and warehouses are classified as such explicitly to support export promotion and they work well. However, since the export processing zone that defines the terms of bonding is not geographically based, bonded factories are located throughout the country. They have had a difficult time taking advantage of adjacent domestic supply sources

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[30] Rhee *et al.*, 1984; Rhee and Belot, 1990; World Bank and USAID, 1991.

since the law does not provide for tax-free treatment of indirect inputs into the production of exports.[31]

Another potential problem relative to FTZs is the extent to which they actually differentiate between companies that meet certain criteria and those that do not. For example, the *arrêté* that created the free industrial zone in Madagascar (arrêté no. 2161/90) does not indicate whether investments pursuant to restructuring of a public enterprise qualify under the investment code for preferential treatment.[32]

Exchange controls. The process of structural adjustment often includes the devaluation of the local currency to more accurately approximate its actual market value. The extent of exchange controls depends on the nature of the currency valuation regime, i.e. whether exchange rates are fixed or floating and whether they are pegged to a single currency, to a basket of currencies or to another numeraire such as ECUs (European currency units) or SDRs (Special Drawing Rights of the IMF).

Most countries have monetary control over the creation and valuation of a national currency that is unique.[33] Bearing in mind that the entire national economy is potentially affected by an alteration in the exchange regime, a study of the constraints to nontraditional exports would be remiss if it did not include evaluation of the costs associated with continued exchange controls.

Retention. In order to control the value of a currency, central banks frequently retain all foreign exchange and issue lines of credit to individual firms. Payments due in foreign exchange are made directly from the central bank, which can then control not only official reserves but also all (or most) of the convertible currencies within national borders. If the central bank maintains a realistic (i.e. market-equivalent) value of the local currency through some other mechanism, such as a limited auction, then additional retention of foreign exchange is unnecessary and, in fact, distorting to the functioning of the currency market. The qualifications necessary to gain access to foreign exchange auctions, or any other allocation mechanism, may unreasonably discriminate against firms of a certain size or complexity, rendering them bankrupt when it comes to dealing with customers and suppliers in the international marketplace.

Most developing countries do not have freely convertible currencies, preferring to exercise their rights to maintain Article XIV status under the Articles of Agreement of the International Monetary Fund, which permits member countries to maintain exchange restrictions

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[31] World Bank. *Mauritius: Expanding Horizons*. A World Bank Country Study. Washington D.C., 1992. p. 37.

[32] Brief 8/90, p. 8.

[33] CFA countries constitute a special, but very important, example of the potential constraints on a nation's ability to change exchange controls. Since several African nations participate in the CFA zone, and since the CFA is pegged to the French franc, no one country has the power to alter the exchange controls without permission of the other members.

during "transitional" periods of economic difficulty.[34] Since foreign exchange controls are often linked to general monetary control within the economy, in an effort to control credit and inflation, the allocation of foreign exchange often becomes a direct function of general monetary policy. The advent of more indirect controls over the money supply can distance the interdependence of money creation and foreign exchange allocation, through such mechanisms as sterilization--using open market operations to offset changes in the money supply resulting from foreign exchange transactions.

As with other areas of the legal regime facing exporters, the unbiased and transparent administration of foreign exchange laws is critical to efficiency and growth. Any unequal treatment increases uncertainty and the implicit transaction costs for businesses.

Legal infrastructure underlying business regulation

Just as an independent judiciary is required to support the existence of a legal system based on property rights, contracts, and torts, so is a human and systemic legal infrastructure required to maintain a viable system of business regulation. Often, however, the legal infrastructure suffers from problems inherent in the profession in developing countries as well as confusion concerning the efficacy of the written law itself.

Problems in the legal profession. Many developing countries suffer from three basic problems in the legal profession: a dearth of lawyers to represent the private sector, an underpaid bank of judges, and a broad fear of repression by government authorities within the profession. These three problems, whether they exist simultaneously or in isolation, contribute to the inability of the legal system to operate fully, fairly, and transparently. Too few lawyers means that those who do practice can charge exorbitant rates for their services and service only those clients who can afford them. Underpaid judges lead to great incentives for corruption. Fear of repression leads to breakdown of the very rule of law. All of these problems are exacerbated by a lack of training and professionalism within parts of the legal profession.

Conflict between written law and customary law. While such conflict is certainly not limited to developing countries, the disparities between written and customary law in Africa and other developing regions are often extreme. Boundaries imposed by former colonial powers without regard to existing patterns of culture and ethnicity mean that many nation states today are characterized by more than one dominant language and cultural tradition, many of which are not written. The result is that what written law exists often codifies rules, customs, and behavioral patterns far more suited to European than local tradition. Indeed, due to poor transportation and communication infrastructure, large proportions of the population of a given country may be living under the jurisdiction of a body of written law of which they are totally ignorant. In such cases, customary law necessarily supersedes the written law, insofar as the written law is rendered functionally irrelevant.

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[34] IMF Articles of Agreement, XIV (2).

Because of the colonial histories of most countries in sub-Saharan Africa, the concept in Western societies of law evolving naturally in response to the need to organize human interaction simply does not apply. The disparities between customary law and national and international written law are crucial to understanding the barriers to nontraditional export growth when the rules of the game governing domestic production and commerce differ markedly from international norms.

French commercial tribunal. The commercial tribunal is a uniquely French vehicle which exists in many francophone countries and has no Anglo-Saxon equivalent. The tribunal is a form of court, officially operative as an institution of the judiciary, but composed of a combination of jurists and lay people with experience in commerce and industry. The tribunal adjudicates only disputes that pertain to commerce and industry and that arise between private parties. The tribunal relies heavily on arbitration and mediation in handing down its decisions.

Predictability and transparency. Whatever laws and regulations exist must be published and accessible. Too often, businesses and individuals are held accountable by enforcement agents for laws and regulations of which there is no public knowledge or, worse, that do not exist. Inversely, certain individuals or companies may be granted special favors by public authorities in the form of exclusion from a law or regulation, permitting them to conduct business at a relative advantage compared to their competition. Either phenomenon represents a barrier to predictability and transparency of the business regulation regime, and ultimately increases uncertainty and stifles growth throughout the private sector.

Private Institutions That Reduce Transaction Costs

Banks

Baseline. Since exporters need to be able to operate on a level playing field with international competitors, the baseline for bank lending will be defined by internationally accepted practice with respect to 1) range of credit instruments, 2) credit controls, 3) interest rates, 4) procedures of obtaining credit, 5) collateral and 6) procedures pursuant to foreclosure, bankruptcy or credit contract enforcement.

Credit instruments. The range of credit instruments available to exporters is not only an indication of reform within the financial sector and transition to a market economy. The range of credit options also serves as a measure of how well positioned potential exporters will be to compete in the international market, where it is assumed that credit constraints are driven by economics rather than politics or underdevelopment of the financial sector. In sub-Saharan African countries, especially, where credit markets remain largely undeveloped, constraints to nontraditional exports frequently lie in bank lending practices.

Rhee has identified the domestic letter of credit (L/C) as crucial to Korea's export growth.[35] Guaranteed lines of credit, issued by a domestic bank and backed by a customer

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[35] Rhee, 1984.

order, guarantee equal access to credit for all exporting firms and producers of potential exports. Rhee credits this credit innovation, developed in Korea, as a crucial source of incentives for small producers to tailor their manufacturing processes for export and invest in order to meet an international quality standard.[36] A survey of African firms specializing in manufacturing for export noted that access to adequate financing is a major concern in many countries (although not as important as lack of capacity to export, government failure to implement export policy effectively and poor infrastructure).[37]

The availability of L/Cs (or L/C equivalents), the extent of a discount market, and the procedures required in order to qualify for automatic credit options will be a focus of study. While most countries in sub-Saharan Africa rely on overdraft facilities or self-financing for export credit purposes, examples of more "modern" instruments do exist. Pre-shipment export finance guarantees (PEFGs) and export credit insurance/guarantees (ECI/Gs) are in use in Nigeria and Uganda, as are rediscount facilities for pre-shipment and (short-term) post-shipment credit for nontraditional exporters.[38] Since reform and privatization of the financial sector often has been a part of more general policy reform in many countries undergoing structural adjustment, such instruments are being introduced, albeit slowly, as part of the credit package available to private exporters in Africa.

Interest rates. The choice of entrepreneurs to invest depends in large part on the prevailing interest rate. Disincentives to invest arise when information concerning interest rates is not immediately available, when banks are perceived as large profit-takers (often possible through the maintenance of a wide margin), or when nominal interest rates are determined differentially across sectors or without regard to inflation. Many firms may be forced to seek credit in the informal sector at much higher nominal rates. How interest rates are set by commercial banks often is a function of the nature of monetary control. In general, the more competitive the financial sector is with respect to the business of lending, the more transparent will be the market, the lower will be margins, and the more market-driven will be interest rates. How the interest rate regime distinguishes between short- and long-term lending also deserves research, since distortions can arise if the differential rates are not market-driven.

Collateral. Requirements governing the use of collateral can also prove to be problematic if the procedure of transferring a secured interest in inventories or capital equipment is not clear legally. Disincentives to borrow may also exist if the rights of creditors and debtors over collateralized property are not clearly delineated in legal, contractual terms or if creditors are viewed as having an inherent advantage in legal terms (see discussion of property rights above).

Banks and other commercial lenders may likewise have a disincentive to lend if the requirements regarding collateral are too loose. Especially in countries where competition exists

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[36] Ibid., p. 13.

[37] World Bank and USAID, 1991, pp. 51-54.

[38] Rhee, 1991, p. 94.

for the provision of financial services, the security of collateral must replace other means of ensuring returns on loans when lending margins are slim.

Securities markets

Another method for potential exporters to generate working capital is through securities markets. While there are no developed markets for stocks (and bonds) in many sub-Saharan African countries, they do exist in some (Côte d'Ivoire, for example, opened a stock exchange in Abidjan in 1990-91, the first exchange in sub-Saharan Africa outside of South Africa). The extent to which smaller companies, especially, can gain access to this type of financing can determine the success of export ventures.

As a rule, countries in which the banking sector is not market driven will tend to lack secondary and even primary securities markets. Markets are just beginning to emerge even for government securities.[39] Moreover, a large public sector borrowing requirement (PSBR) in many countries tends to crowd out other types of financing including securities financing within the private sector. Consequently, markets for private securities are embryonic at best and may occur only in the informal sector in the guise of (legally) unsecured interests in future profits of particular firms. Before markets for securities can emerge in many countries, the legal regime governing the establishment of private business--the right to incorporate, to issue shares, to make and retain profits, to gain access to foreign markets in the first place--must be clarified.

Service companies

Finally, in many countries, special regulations apply to specific industries that service the private sector. In most industrial countries, for example, a particular body of regulation is geared toward the financial sector and all of the trading companies and brokerage houses that operate within it. In the U.S., The Securities and Exchange Commission (SEC) is charged with administering this body of law. Likewise, the insurance industry in many countries is regulated in terms of allowable margins, rate increases, and other issues with a broad social dimension.

While such companies and industries may be developed only in a limited fashion in the developing countries of sub-Saharan Africa, the regulation or lack thereof pertaining to such issues as insider trading or insurance rate gouging can have a profound effect on the efficiency of the private sector. The government has a role to play in regulating the business practices of such service companies and the extent to which the State overplays or underplays this role falls within the purview of this methodology as well.

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[39] Duesenberry and McPherson, 1991.

ANNEX B: METHODOLOGY FOR MEASURING COSTS ASSOCIATED WITH INSTITUTIONAL CONSTRAINTS

In this section the methodology for measuring costs associated with institutional constraints is described in detail, using specific examples of problems outlined in the previous section. Although the procedural approach to cost estimation is general in scope, the specific measurement techniques employed differ by constraint, depending on the type of costs incurred.

Identification of Potential Export Industries

The first step involves the identification of potential export industries in agriculture and manufacturing on the basis of one or more of the following criteria:

1. current level of exports;
2. historical level of exports;
3. intensive use made of locally produced raw materials;
4. intensive use made of unskilled labor;
5. agricultural crop produced in an ecological area that is particularly favorable.

The list should be based on experience in other countries as well as in the country being studied.

Verification of the Potential Profitability of Exports

In order to verify the potential profitability of exports, comparative cost and incentive indicators are calculated assuming that the product is exported. The comparative cost indicator is the domestic resource cost (DRC); the comparative incentive indicators are the effective protection coefficient (EPC) and the effective subsidy coefficient (ESC).

Domestic resource cost

The domestic resource cost (DRC) is an indicator of the efficiency with which a country's factors of production are converted into a product. More precisely, the DRC for a given economic activity is the ratio of the social opportunity cost of the domestic nontradable resources used in the production of tradable output j to the value added that is created by this activity, where that value added is measured in world market prices, assumed to equal the shadow prices or social opportunity costs of tradable goods. An economic activity is defined in terms of a given product, technique and location of initial production, technique and location of subsequent processing, marketing channel, and location of final sale at the wholesale level.

$$DRC_j = \sum \frac{f_{sj}P_s^*}{P_j^* - \sum a_{ij}P_i^*} \tag{1}$$

where f_{sj} is a technical coefficient relating nontradable primary factor s (land, labor, capital) to output j,

a_{ij} is a technical coefficient relating tradable intermediate input i to tradable output j,

P_s^* is the social opportunity cost of factor s,

P_j^* is the world market price of output j,

P_i^* is the world market price of input i.

If there are intermediate inputs that are nontradable, these are broken down into their tradable intermediate input and nontradable primary factor components. The numerator of the DRC given in equation (1) thus represents the opportunity cost of all nontradable primary factors employed both directly in the production of output j and indirectly in the production of inputs used in the production of j. Similarly, the denominator equals the value of output less the value of direct and indirect tradable inputs, each measured at their opportunity cost in terms of world market prices.

The distinction between tradables and nontradables is critical to the analysis insofar as the exchange rate is concerned. Both numerator and denominator of the DRC are given in the same currency by multiplying the latter by the social opportunity cost of foreign exchange, or the shadow exchange rate, which expresses the marginally efficient rate at which nontradable primary factors of production may be transformed into tradable value added. Once this is done, the numerator and denominator of the DRC may be compared to see whether activity j is more or less efficient than the activity that, at the margin, is just efficient. If the DRC is less than one, the domestic resource cost per unit of value added is less for activity j than for the marginally efficient activity, so the country has a comparative advantage in activity j. If the DRC is greater than one, the opposite is true and the country does not have a comparative advantage.

An alternative to the DRC measure is net social profitability (NSP), obtained by subtracting the numerator from the denominator of equation (1).

$$NSP_j = P_j^* - \sum a_{ij}P_i^* - \sum f_{sj}P_s^* \tag{2}$$

If NSP>0 (DRC<1), then the country realizes a net gain from this activity; if NSP<0 (DRC>1), the country realizes a loss. The NSP indicator is expressed in units of output, which prevents comparisons being made of the relative profitability of activities involving different products. The DRC is a ratio, on the other hand, which expresses the amount of gain that can be achieved per unit of scarce domestic resources. With the DRC, therefore, different activities can be compared. The lower the DRC, the more efficient is the activity that it measures.

Nominal and effective protection

While the DRC indicator is related to the theory of comparative advantage, nominal and effective protection refer to the structure of incentives involving international trade (import duties, export taxes, quantitative restrictions on imports, etc.). Nominal protection may be measured either as the nominal protection coefficient (NPC = P_j/P_j^*) or as the nominal rate of protection (NRP = NPC - 1), where P_j is the domestic price of output j. These indicators measure the degree to which consumers are either taxed or subsidized by trade policy. If the NPC is greater than one (NRP>0), they are being taxed because they are paying prices that are higher than those paid on the world market; if the NPC is less than one (NRP<0), they are being subsidized vis-à-vis the world market.

Effective protection measures incentives that affect the prices of both outputs and tradable inputs; it is therefore a better indicator of protection offered to producers. The effective protection coefficient (EPC), which measures value added in domestic prices relative to value added in world prices, is given by equation (3). The effective rate of protection is obtained from this by subtracting one (ERP = EPC - 1). If the EPC is greater than one (ERP>0), producers

$$EPC_j = \frac{P_j - \sum a_{ij}P_i}{P_j^* - \sum a_{ij}P_i^*} \tag{3}$$

receive positive incentives vis-à-vis the world market; if EPC<1 (ERP<0), producers receive negative protection, i.e., the structure of tariffs and other trade distortions places producers at a comparative disadvantage in world markets. The denominator of the EPC is the same as that of the DRC if each is measured at the shadow rate of exchange. This is the measure of equation (3) that is assumed here.

Effective subsidy coefficient

The numerator of the EPC shows the scope allowed by world prices and trade distortions for some combination of domestic resource costs, monopoly profits, externalities, economic rents on fixed factors of production, and distortions in the prices of nontradable factors of production resulting from taxes and subsidies on these factors. The numerator of the DRC, on the other hand, consists only of domestic resource costs. The EPC thus indicates the potential for incurring domestic resource costs, whereas the DRC measures the degree to which these costs are actually incurred. The numerator of the EPC can be adjusted for taxes and subsidies on nontradable factors of production. The resulting indicator, known as the effective subsidy coefficient (ESC), is shown in equation (4).

$$ESC_j = \frac{P_j - \sum t_{sj} f_{sj} - \sum a_{ij}P_i}{P_j^* - \sum a_{ij}P_i^*} \tag{4}$$

where t_{sj} is the net tax (negative if a net subsidy) imposed on each domestic factor used in producing output j. In the absence of monopoly profits, externalities, and economic rents, the ESC will equal the DRC.

Integrated Model for Policy Analysis Computer Template

The Integrated Model for Policy Analysis Computer Template (IMPACT), which has been developed by AIRD as a standard tool for conducting DRC/NPC/EPC/ESC analysis, is used to calculate these indicators for the different products selected as having an export potential. This template greatly facilitates sensitivity analysis on different parameters such as the shadow exchange rate, world market prices, and transportation costs. It also substantially lessens the time and effort required to set up the original models.

Identification of Current Export Constraints and Their Effects

Despite instances in which many African countries had a comparative advantage in exporting certain products, these exports were severely constrained for many years by a distorted policy environment. These policy distortions included overvalued exchange rates, import taxes and quotas, and taxes and marketing board profits assessed on exports. The effect of these distortions in biasing the allocation of resources away from exports was twofold. First, the overvalued exchange rate penalized production of exports vis-à-vis nontradables. Second, the effect of trade taxes and quotas and of marketing board profits was to favor the import-competing sector relative to the export sector.

Most of these biases have disappeared or at least been decreased, in the process of structural adjustment, through devaluation and the elimination or reduction of import tariffs and quotas, export taxes, and marketing board profits. Thus domestic prices in most countries today reflect relatively well the structure of world prices. Yet growth of exports is still limited by a number of other constraints. Among these are inadequate infrastructure, lack of information, and weak institutions linking the public and private sectors. Although this paper is concerned principally with the last of these constraints, a short discussion of the others helps to place the institutional side in perspective.

Infrastructure

Among the first constraints to appear after major price distortions have been corrected are those involving infrastructure. Frequently, the road network is inadequate and in very bad condition. Port and airport facilities are too limited to handle substantial volumes of external trade. Telecommunications, which are essential to link suppliers with overseas markets and to assure timely delivery, are very weak and unreliable. The same may be said of essential utilities, such as delivery of power and water.

The effect of these constraints is to add substantially to export costs, to increase the uncertainty of timely delivery, and to limit the ability of local producers and traders to establish

and maintain linkages with overseas markets. This has an effect similar to that of trade taxes or an overvalued exchange rate in that it protects production for the local market and reduces the profitability of exports. Yet the DRC analysis treats these as costs rather than as protective policies that influence incentives.[40]

The reasons for this are clear. Poor transportation infrastructure adds substantially to the cost of delivering products from the farm or plant to the buyer. Investment in infrastructure leads to a reduction in these costs, which is treated as a benefit in conventional cost-benefit analysis used to determine whether this investment should be made. Since this investment is costly, however, the higher transportation rates that are charged in its absence should be treated as a real economic cost in the DRC analysis. Once the investment is made, these costs are reduced, but the resources used for this investment are in themselves a real cost. To the extent that the investment is profitable, however, there may be some scope for testing the sensitivity of the DRC results to a change in transportation costs, though allowance should be made for the investment as well as recurrent costs.

Information

Information may also be acquired by investing in research, extension, market networks, and other ways. This type of investment is critically important to the expansion of nontraditional exports because it helps to define the products to be exported, the production and processing techniques to be employed, and the market channels to be followed. Yet the costs of this type of investment are difficult to incorporate into any particular EP/DRC model because the investment is used to define the activities that are analyzed rather than to reduce the costs associated with existing activities. Once an activity has been defined with respect to product, technique, and location of production, processing, and marketing, EP/DRC analysis may be employed to see whether the activity is profitable. If it is not, the search for new activities must continue until profitable activities have been found.

The benefits from this type of investment result from the gains associated with reallocating resources away from unprofitable activities towards those that are more profitable. These gains may be estimated by aggregating the net social profitability of each activity multiplied by the level of that activity both before and after the investment in information has been made. This requires not only the results of the DRC analysis but also estimates of demand and supply functions for each product.[41]

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[40] In its analysis of regional specialization and agricultural growth in Madagascar, AIRD looks at transportation infrastructure in two ways in its EP/DRC analysis. First, it performs sensitivity analyses in which the cost of transport varies as a result of improvements in roads and port facilities. Second, it projects the volume of domestic and external trade, assuming rational exploitation of the pattern of comparative advantage, in relation to the capacity of roads and ports, in order to identify future bottlenecks. Stryker, Metzel, and Timmer, *Regional Specialization and Agricultural Growth in Madagascar.*

[41] In addition, the general equilibrium problems noted earlier would also apply.

Institutions

The focus of this study is on the legal, regulatory, and judicial institutions linking the public and private sectors, and on the ways in which these institutions act as a constraint on the growth of nontraditional exports. Of particular importance are ways in which this institutional environment provides for (1) provision of public goods, including attempts to attain objectives other than economic efficiency, (2) payment for these goods through taxation and other mechanisms, and (3) compliance with the rules required for providing and paying for public goods. Closely related to these goals is the concept of rent-seeking behavior undertaken by the private sector in response to action engendered by the government.

Provision of public goods. The principal, and most legitimate, role of government, according to most economists, is to provide public goods. These goods are defined as being (1) collectively consumed (i.e., marginal cost of an additional user equals zero) and (2) non-exclusive, i.e., excluding anyone from their consumption is impossible. The classic example is national defense, since collective consumption by some does not subtract from consumption by others, and there is no way to exclude some people if the rest of the population is already being protected.

Much of the legal, regulatory, and judicial environment involves the provision of public goods. The creation of a sound and secure business environment through a well-defined system of property rights, contract law, corporate law, and other elements, for example, benefits the entire population by creating conditions that are necessary for sustained economic growth. Other laws and regulations are designed to promote objectives other than economic efficiency, such as safety, equity, and national independence. Many of these laws and regulations are aimed at protecting particular segments of the population, such as labor. Nevertheless, these laws and regulations reflect the views of society as to what is just and proper, in addition to what is economically efficient, and they can thus be considered in a very broad way as producing public goods even if the entire population does not benefit.

Payment for public goods. The collective nature of public goods implies that decisions regarding payment for these goods cannot be left up to individual firms and households, which have an incentive to become "free riders," benefiting from the goods along with everyone else regardless of whether or not they choose to pay for them. As a result, decisions regarding the provision of public goods, along with the obligation to pay for them, have to be made collectively. This normally involves involuntary taxation or some other mechanism for required payment.

Compliance. Closely related to the provision of and payment for public goods is the need for compliance. Laws and regulations regarding business, for example, need to be complied with if they are going to be effective. Assuring compliance requires legal, regulatory, and judicial mechanisms for dealing with those who fail to comply. In many cases in developing countries, these mechanisms are inadequate or too expensive, so that actual practice may differ substantially from what is on the books.

Rent-seeking behavior. Rent-seeking behavior occurs when the private sector responds to incentives offered by the public sector in ways that waste scarce resources, not by allocating

them in ways that are inefficient, but by using them for "nonproductive" purposes. An example results from the establishment of an import quota, which pushes up the price of importable goods on the domestic market while importers continue to have access to imports at the world market price. As the quota premium, or "rent", earned on each imported good rises, importers are induced to compete with one another to obtain scarce import licenses. This competition can take the form of long hours spent waiting outside a government official's office, filling out mountains of paperwork, or other nonproductive activities. Most economists, however, do not extend the concept of rent-seeking behavior to include action, such as lobbying, that induces the government to restrict imports so that the importer might be able to benefit by obtaining a license. This action is instead thought to be a "productive" transaction cost associated with the making of public decisions. The distinction between nonproductive rent-seeking behavior and productive transactions costs, however, is not always clear.[42]

Traditionally, in economics, rent has been defined as the return to a given resource used in a particular activity which is in excess of the return that would be necessary in order to induce the use of the resource in that activity. Rent is often associated with land that has no opportunity cost in alternative uses. In fact, most resources earning rents do have some opportunity cost, but it is less than the return they earn in the rent-producing activity.

The existence of rent leads to wasteful competition to capture it unless there are rules regarding access. One of the most important of these is that of private property, which allows the owner to appropriate the entire rent by excluding others from using the resource unless they pay the value of the rent to the owner. Where property is held in common and there are no rules governing access, competition leads to squandering of the rent. This problem is well recognized in the literature on natural resource management.

To the extent that the government creates public goods and the means to pay for them, it also creates rent-seeking opportunities, i.e., opportunities for the private sector to gain the rents that the government is trying to appropriate for the public. What matters is not that rent-seeking opportunities are created -- this is inevitable as long as public goods are being produced and paid for -- but that these rents be transferred to the public in as equitable and efficient manner as possible. As an example, it is generally believed that an import tariff is preferable to an import quota when the government deems it desirable to create a public good by protecting domestic industry against imports, because the tariff not only protects industry but also transfers resources from consumers to the government, rather than to importers who waste these resources as they compete to obtain them through rent-seeking behavior.

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[42] Gallagher defines rent-seeking as "the direct use or waste of economic resources for non-economic gains" (Mark Gallagher, *Rent-Seeking and Economic Growth in Africa*, Boulder: Westview, 1991, p.31). Clearly this can be a very broad definition, which depends critically on what is meant by "non-economic gains". The author goes on to infer that rent-seeking activity is directed towards capturing the scarcity premia that result from government regulation, taxation, and other activities, but he also suggests that it includes the lobbying that goes into influencing these activities, as well as non-governmental activities such as efforts by labor unions to transfer income from management and consumers. The problem with this definition is that it can be construed to include any human endeavor that uses scarce resources but does not involve the buying and selling of these resources in the market. Possible examples include political campaigning, waging war, and spending time on leisure activities. The definition offered here is much narrower.

Effects of Institutional Constraints on Comparative Costs and Incentives

Earlier it was argued that infrastructural constraints generally operate to raise costs rather than to alter incentives. Investment in roads, ports, telecommunications, and other improvements can reduce these costs, if the investment is profitable, but the resources used for the investment will themselves be costly. Investment in information may also reduce costs, but it is probably better in the DRC/EP models to consider this investment as defining new activities.

Institutional constraints may be considered either as costs or incentives (or, more properly, disincentives), depending upon the feasibility of their being alleviated through policy reform. If the easing of an institutional constraint appears feasible, that constraint should be treated as an export disincentive; if it does not seem feasible, the constraint should be considered as a real cost. Long delays experienced in clearing imported inputs through customs, for example, are a disincentive to the production of exports rather than a real cost because the delays could be shortened relatively easily. As with other nontariff barriers, these delays are likely to result in rent-seeking behavior to take advantage of the profit that can be gained by clearing customs quickly. The delays also encourage substitution of locally produced inputs for imported ones.

Restrictions on bank credit that result in firms having to pay higher costs for their capital in the informal sector would appear, in the first instance, to act as a disincentive to capital investment. However, this disincentive may not be so easy to correct. A recent study suggests that most African countries lack the instruments of monetary policy that would be necessary in order to move away from direct credit restrictions to more indirect means of limiting the supply of money and credit.[43] This suggests that fragmentation of the capital market in Africa, which results in substantially higher costs of capital for firms that are not well established in the formal sector, is not very amenable to policy reform. As a result, the higher costs associated with recourse by these firms to the informal sector are real and not simply distortions introduced by public policy.

The distinction between the effects of institutional constraints on incentives and on real costs must be carefully evaluated, therefore, in terms of the durability of these constraints and of the costs of lessening or removing them. Most analyses assume that economic policies distort incentives and that these distortions should therefore be treated as financial rather than economic costs. This ignores, however, the real costs that may be associated with the elimination of these policies. Many of the costs of policy reform may be transitional, but they are costs nevertheless. For example, removal of an tax on imports may cause import-competing firms to go out of business, with the possibility of substantial losses being incurred over and above those associated with windfall losses on fixed capital. In a similar way, institutional factors must be evaluated to determine whether they are constraints that should be removed, real costs that must be incurred, or something in between.

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[43] Duesenberry and McPherson, 1991.

By this interpretation, economic and other types of policies comprise a subset of a broader range of institutional constraints -- a subset that is believed to be susceptible to manipulation by policy makers without incurring prohibitively high costs. At one end of the spectrum are institutional constraints that can be removed without incurring any cost; at the other end are immutable constraints for which the costs of removal are prohibitively high. In between, of course, is a range of mutable institutional constraints that may be removed or otherwise manipulated at a cost that is less than prohibitive.

There is, of course, a need to distinguish between the real economic costs that are incurred through the manipulation of institutional constraints and the costs as perceived by policy makers. The latter are likely to be influenced by pressures from those who experience a change their welfare, some of which they may derive from their access to rents created by the constraints. Although part of these rents is likely to be wasted through rent-seeking behavior, part is also normally passed on to those who are especially skilled in acquiring the rents or who derive monopoly advantage in some other way.

An example may be drawn from the area of trade policy. Most economists would agree that taxes and subsidies on trade should be considered as mutable economic policies. They would probably go on to argue that the same should be said for trade restrictions such as import quotas. But they might hesitate when it comes to other nontariff barriers such as the time it takes to clear customs, when in fact this might be much more important than the actual tariff paid. By the standards of the Newly Industrializing Countries (NICs), this time might considered as totally unreasonable, but by African standards it might be the norm. On the other hand, delays in clearing customs give rise to rents, some of which are likely to be transferred to customs officials as bribes or in other ways. These officials are likely to argue that the delays are necessary in order to assure that otherwise desirable regulations, such as restrictions on the importation of unsafe materials, are complied with. Should these delays be considered as a form of economic policy affecting the structure of incentives? Or should they be thought of as a real cost of doing business in Africa? Or perhaps they should fall somewhere in between. These questions are often very difficult to answer, yet the way in which they are answered very much influences the analysis.

Estimation of Costs and Incentive Distortions

Institutional constraints increase costs or distort incentives, depending on whether the constraints are amenable to manipulation, in a number of different ways. These depend on the nature of the constraint and on how the individual economic actor responds to it. This response, in turn, depends on the original cost of the constraint and the extent to which lower cost alternative courses of action are available. Among the options available are (1) compliance with laws and regulations without avoidance, (2) compliance with laws and regulations with avoidance, (3) influencing discretionary government decisions, and (4) evasion of laws and regulations. Costs may be direct, out-of-pocket expenses or they may be imputed costs that result from the tying up of resources that otherwise might be put to more productive use. There are also implicit costs associated with risk and uncertainty. Each of these costs (distortions) is described here along with ways in which it can be measured. A few illustrative applications are made to particular types of constraints.

Compliance with laws and regulations without avoidance

Firms may comply with laws and regulations without taking any action to avoid their adverse effects or to benefit from those that could affect them favorably. This type of compliance could be very costly. The direct cost associated with compliance might include:

1. fees required for the registration of personal, real, and intellectual property and for the conduct of business;

2. customs duties and other taxes, adjusted for advantages obtained as part of investment incentive schemes, free-trade zones, etc.;

3. legal and accounting fees required to understand and comply with laws and regulations;

4. direct costs associated with foreclosure;

5. direct costs associated with gaining access to foreign exchange;

6. labor compensation that must be paid as a result of laws protecting workers in the formal sector.

Estimation of these costs is generally straightforward once the nature of the costs is understood and it is clear to what extent the firm is obliged or chooses to pay these costs.

Firms may also incur substantial imputed costs in their attempts to comply with laws and regulations. Probably the most important of these are the value of managerial time and the cost of capital tied up awaiting government action. The cost of capital can include inventories and other forms of working capital, fixed plant and equipment, real estate, and various forms of human capital, including training, education, intellectual property, etc. Among the more important actions that give rise to these imputed costs are:

1. registering and using as collateral personal, real, or intellectual property;

2. foreclosure on property used as collateral;

3. execution of sales and other contracts;

4. obtaining bank loans;

5. obtaining approval for investment by foreign companies;

6. bargaining and otherwise dealing with labor unions;

7. obtaining approval for access to investment incentive schemes and free trade zones, and the implementation of those schemes once access has been obtained, including tax holidays, duty drawbacks and exemptions, etc.;

8. obtaining trade licenses, passing product standards, clearing customs;

9. dealing with regulations regarding foreign exchange;

10. dealing with regulations regarding competition law.

Measurement of these implicit costs requires (1) ascertaining the nature of the costs, (2) estimating the quantity of resources (e.g., management time, capital) that are tied up and for how long, and (3) multiplying the quantity-time by the cost of these resources (e.g., management salaries, interest rate).

Many institutional constraints related to the legal, regulatory, and judicial environment result in increased risk and uncertainty. One of the most important of these constraints involves the arbitrary exercise of executive power. If carried out at sufficiently high a level, this can affect any aspect of business activity and is often very difficult to predict. At lower levels, risks are perhaps better understood and more manageable. They generally involve the use of discretionary authority by public officials, which may be predictable with some degree of accuracy and, as seen below, is often amenable to some form of influence. Measuring the cost associated with this risk involves (1) determining the source of risk, (2) estimating the magnitude of the risk, and (3) assessing the degree of risk aversion on the part of exporting firms.

Compliance with laws and regulations with avoidance

The adverse consequences of most laws and regulations can be partially avoided through legal means even as the laws and regulations are being complied with. Firms may also act in ways that cause them to receive favorable treatment in the implementation of the laws and regulations under established policies and procedures. The result is usually costly in terms of wasted resources.

The most obvious example of avoidance is efforts by firms to exploit loopholes in order to diminish their tax burden. This differs from tax evasion, which is illegal. The decision of whether or not to incorporate, for example, may be determined by the tax obligations involved. Certainly the choice of whether to locate in the formal or the informal sector is strongly influenced by the desire of firms to avoid the taxes that are assessed in the formal sector. In each instance, additional economic costs are incurred in order to reduce the firm's financial tax burden.

Action may also be taken to influence government decisions regarding how firms are to be treated. This requires that the rules for such treatment be known to the firms. One important example is the granting of import licenses and other advantages based on the size of the firm as measured by number of employees, installed capacity, level of production, or other indicators. This acts as a strong incentive to engage in economically inefficient behavior so as to receive the

benefits involved. As another example, prior to the abolition of import licensing in Nigeria in 1986, preferential treatment was given in the granting of licenses to agricultural enterprises. This resulted in the establishment of numerous unprofitable farms for the sole purpose of acquiring these licenses.

Measurement of the costs of avoidance and other such actions is similar to measuring the cost of full compliance in that it can involve direct, imputed, and risk-related costs. These costs should be calculated relative to a situation in which the laws and regulations did not exist. As an example, taxes on imported inputs may be avoided by purchasing these inputs, to the extent that they are available, on the local market. This will usually be more costly than importing them exempt from import duties. It may also involve some loss of quality, though the cost of this will be more difficult to measure. Although duty drawback and exemption schemes may make this type of tax avoidance unnecessary for exporting firms, it is likely to remain a problem for their suppliers.

Influence over discretionary government decisions

Frequently, firms will attempt to avoid compliance with laws and regulations or to assure favorable treatment by exerting influence over discretionary government decisions (i.e., decisions not based on established policies and procedures, as discussed above). This can be done in a number of ways, which may be either legal or illegal. The most obvious way is through outright bribery. Alternatives to bribery include granting of favors legally, exerting outside pressure, and sheer persistence. All of this is likely to involve direct or imputed costs in the form of cash, management time, and tied up capital. There are also likely to be risks since, despite the cost incurred to influence government decisions, the outcome is not always certain. Methods of estimating these costs are similar to those associated with legal compliance, though obtaining the necessary information may be more difficult.

Evasion of laws and regulations

Illegal evasion of laws and regulations may take any number of forms. One of the most obvious is smuggling, which often is costly because transportation via a smuggling route is likely to be more expensive than if goods are traded legally. Over or under-invoicing and other methods of falsifying documents are other common ways of avoiding trade and other taxes. The possibility of evading laws and regulations implies that the government must expend resources to reduce or eliminate this illegal behavior. Although not a financial cost to the firm, these resources represent an economic cost to society that may influence the real costs of exporting -- in assuring, for instance, that product quality standards are adhered to. Again, direct, imputed, and risk-related costs may be involved.

In measuring the cost of evasion or of preventing evasion, it is important to bear in mind the baseline standard so as to assure that costs are measured in the right direction. Certain types of illegal behavior may be desirable if laws and regulations are very restrictive and depart substantially from international standards. On the other hand, widespread evasion of a nation's laws and regulations is, over the longer term, likely to be highly detrimental to the establishment

of a stable environment in which nontraditional exports can flourish. If the legal, regulatory, and judicial environment is so distorted that such evasion appears socially desirable, then the first priority is to reduce or eliminate these distortions. This has, in fact, been the goal of most structural adjustment programs. Once this is done, attention can be shifted to measuring the cost of preventing evasion when this cost is likely to influence nontraditional exports. Only in exceptional cases, under these conditions, should the cost of evasion be considered as a real cost of exporting.

Recourse to the informal sector

There is one major exception to the rule that the cost of evasion of laws and regulations not be considered as a real cost of exporting. This relates to the informal sector. Most African countries are characterized by a dual structure regarding the legal, regulatory, and judicial environment. Within the formal sector, records are maintained, taxes are paid, and laws and regulations are generally complied with, albeit with substantial legal or illegal influence over discretionary government decisions.

There is also, in every country, a large and growing informal sector, where records are limited, few taxes are paid, and many laws and regulations are ignored. Firms often have the option of operating within the formal or informal sectors. This may be critically important, in fact, for new firms interested in nontraditional exports. Although there are some advantages associated with being in the informal sector, there are also some important disadvantages.[44]

One of these disadvantages is the generally higher cost of capital. Lack of collateral and the limited resources of borrowers result in high risks to lenders. In addition, costs of administering a large number of small loans are also high. The result is high rates of interest to the borrower. One way of measuring the cost of controls on bank credit in the formal sector, in fact, is to calculate the increase in cost to the borrower who must have recourse to the informal sector.

Another disadvantage of the informal sector is limitations on size. Firms within the informal sector are, almost by definition, small. This is partly because the risks associated with being in that status tend to discourage fixed capital investment. Consequently, there are severe constraints on the ability of successful firms to grow unless they are willing to make the transition to formal sector status. This reduces gains from competition and limits the exploitation of economies of scale. These costs are difficult to measure, but some idea of their order of magnitude is important.

The quality of labor within the informal sector may also be relatively low, especially where skill and management ability are important. Given the scarcity of these factors in Africa, most skilled workers and managers quickly move into the formal sector, where their remuneration is likely to be much higher.

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[44] de Soto, 1989.

Finally, there is the problem within the informal sector of access to legal property rights, contracts, and other benefits of the legal, regulatory, and judicial environment. Although it has been shown that these legal instruments often exist in rudimentary form within the informal sector, they are generally not well established and are at a significant disadvantage vis-à-vis the legal structures of the formal sector.[45] The result is high risks associated with informal sector activity.

[45] de Soto, 1989.

APPENDIX 1: DRC TEMPLATE

CALCULATION OF ECONOMIC INDICATORS:	Date:	22-Sep-94
COUNTRY: GHANA		
PRODUCT: FURNITURE		
FIRM: SAMPLE	SALES/EXP	1.00

INSTITUTIONAL COSTS

IMPORTS	capital costs	41.75		
EXPORTS			Break down of cash costs	
unnecessary imputed labor		600.00	unnec. fees	14061.00
total cash costs		14061.00	loss tax rebat	0.00
loss on foreign exchange		42847.53	excsv. tips	

FOB REFERENCE PRICE				
VALUE OF SALES FOB		1400000.00	ADJUSTED VALUE OF SALES FOB	1465919.28
EXPORT TAX RATE EQUIVALENT	0.0%	0.00	EXPORT TAX RATE EQUIVALENT 3.9%	57508.53
VALUE OF SALES EXPORT, FINANCIAL PRICES		1400000.00	VALUE OF SALES EXPORT, FINANCIAL PRICES	1408410.75
FINANCIAL PROFITABILITY ANALYSIS			**FINANCIAL PROFITABILITY ANALYSIS**	
EXPORT, FINANCIAL PRICES		1400000.00	EXPORT, FINANCIAL PRICES	1408410.75
TRADABLES, FINANCIAL PRICES		572623.67	TRADABLES, FINANCIAL PRICES	572665.42
VALUE ADDED IN FINANCIAL PRICES		827376.33	VALUE ADDED IN FINANCIAL PRICES	835745.33
VALUE OF NON-TRADABLES IN FINANCIAL PRICES			VALUE OF NON-TRADABLES IN FINANCIAL PRICES	
FAMILY LABOR COSTS		0.00	FAMILY LABOR COSTS	0.00
HIRED LABOR COSTS		420685.06	ADJUSTED HIRED LABOR COSTS	420085.06
CAPITAL COSTS		445336.00	ADJUSTED CAPITAL COSTS	432643.53
LAND COSTS		141349.50	LAND COSTS	141349.50
TAXES/SUBSIDIES ON NONTRADABLES		32120.31	ADJUSTED TAXES/SUBSIDIES ON NONTRADABLES	30710.04
TOTAL VALUE OF NON-TRADABLES IN FINANCIAL PRICES		1039490.87	TOTAL VALUE OF NON-TRADABLES IN FINANCIAL PRICES	1024788.13
FINANCIAL PROFITABILITY		-212114.54	FINANCIAL PROFITABILITY	-189042.79
ECONOMIC PROFITABILITY ANALYSIS			**ECONOMIC PROFITABILITY ANALYSIS**	
TRADABLE WHOLESALE PARITY PRICE, ECONOMIC @ OER		1400000.00	TRADABLE WHOLESALE PARITY PRICE, ECONOMIC @ PER	1465919.28
TRADABLES IN ECONOMIC PRICES @ OER		449184.95	TRADABLES IN ECONOMIC PRICES @ PER	449184.95
VALUE ADDED IN ECONOMIC PRICES @ OER		950815.05	VALUE ADDED IN ECONOMIC PRICES @ PER	1016734.33
TRADABLE WHOLESALE PARITY PRICE, ECONOMIC @ SER		1613452.91	TRADABLE WHOLESALE PARITY PRICE, ECONOMIC @ SER	1613452.91
TRADABLES IN ECONOMIC PRICES @ SER		517670.55	TRADABLES IN ECONOMIC PRICES @ SER	494392.00
VALUE ADDED IN ECONOMIC PRICES @ SER		1095782.37	VALUE ADDED IN ECONOMIC PRICES @ SER	1119060.91
VALUE OF NON-TRADABLES IN SHADOW PRICES			VALUE OF NON-TRADABLES IN SHADOW PRICES	
SHADOW FAMILY LABOR WAGE RATE COEFFICIENT		1.00	SHADOW FAMILY LABOR WAGE RATE COEFFICIENT	1.00
FAMILY LABOR COSTS IN SHADOW PRICES		0.00	FAMILY LABOR COSTS IN SHADOW PRICES	0.00
SHADOW HIRED LABOR WAGE RATE COEFFICIENT		1.00	SHADOW HIRED LABOR WAGE RATE COEFFICIENT	1.00
HIRED LABOR COSTS IN SHADOW PRICES		420685.06	HIRED LABOR COSTS IN SHADOW PRICES	420085.06
SHADOW CAPITAL COST COEFFICIENT		1.00	SHADOW CAPITAL COST COEFFICIENT	1.00
CAPITAL COSTS IN SHADOW PRICES		445336.00	CAPITAL COSTS IN SHADOW PRICES	432643.53
SHADOW LAND COST COEFFICIENT		1.00	SHADOW LAND COST COEFFICIENT	1.00
LAND COSTS IN SHADOW PRICES		141349.50	LAND COSTS IN SHADOW PRICES	141349.50
TOTAL VALUE OF NON-TRADABLES IN SHADOW PRICES		1007370.56	TOTAL VALUE OF NON-TRADABLES IN SHADOW PRICES	994078.09
ECONOMIC PROFITABILITY		88411.81	ECONOMIC PROFITABILITY	124982.83
PROTECTION + COMPARATIVE ADVANTAGE ANALYSIS			**PROTECTION + COMPARATIVE ADVANTAGE ANALYSIS**	
NOMINAL PROTECTION COEFFICIENT, OUTPUT		1.00	NOMINAL PROTECTION COEFFICIENT, OUTPUT	0.96
NET NOMINAL PROTECTION COEFFICIENT, OUTPUT		0.87	NET NOMINAL PROTECTION COEFFICIENT, OUTPUT	0.87
NOMINAL PROTECTION COEFFICIENT, INPUTS		1.27	NOMINAL PROTECTION COEFFICIENT, INPUTS	1.27
NET NOMINAL PROTECTION COEFFICIENT, INPUTS		1.11	NET NOMINAL PROTECTION COEFFICIENT, INPUTS	1.16
EFFECTIVE PROTECTION COEFFICIENT		0.87	EFFECTIVE PROTECTION COEFFICIENT	0.82
NET EFFECTIVE PROTECTION COEFFICIENT		0.76	NET EFFECTIVE PROTECTION COEFFICIENT	0.75
EFFECTIVE SUBSIDY COEFFICIENT		0.84	EFFECTIVE SUBSIDY COEFFICIENT	0.79
NET EFFECTIVE SUBSIDY COEFFICIENT		0.73	NET EFFECTIVE SUBSIDY COEFFICIENT	0.72
DOMESTIC RESOURCE COST COEFFICIENT		0.92	DOMESTIC RESOURCE COST COEFFICIENT	0.89

FIRM BUDGET: 22-Sep-94
COUNTRY: GHANA
PRODUCT: FURNITURE
FIRM: SAMPLE

					FINANCIAL EXPENDITU	TAXES/SUBSIDIES DIRECT INPUTS TRAD.	TAXES/SUBSIDIES DIRECT INPUTS NONTRAD.	FINANCIAL COST	TAXES/SUBSIDIES INDIRECT INPUTS TRAD.	TAXES/SUBSIDIES INDIRECT INPUTS NONTRAD.	ECONOMIC COST	TRADABLE INPUTS	.....NON-TRADABLE INPUTS..... FAMILY LABOR	HIRED LABOR	CAPITAL	LAND
FARM PRODUCTION																
UNSKILLED LABOR					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
SKILLED AND SUPERVISORY LABOR					0.00											
PLANTS, SEED, ETC					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
FERTILIZERS					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
HERBICIDES					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
MACHINERY AND SMALL TOOLS					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TRANSPORT FROM FIELD					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LAND RENT					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CAPITAL RECOVERY	INVESTMEN COST	EXPECTED LIFE		ANNUITY COEFF												
land	0.00	50.00		0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
land development	0.00	0.00		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
agricultural machinery	0.00	10.00		0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
irrigation installation	0.00				0.00											
WORKING CAPITAL	0.00	1.42		0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL FARM COST					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PROCESSING/MANUFACTURING COSTS																
RAW MATERIALS	domestic				1314335.00	0.00	0.00	1314335.00	118290.15	13143.35	1182901.50	394300.50	0.00	394300.50	262867.00	131433.50
	imported				17951.00	0.00	0.00	17951.00	359.02	179.51	17412.47	15258.35	0.00	1077.06	1077.06	0.00
TRANSPORT TO FACTORY					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
LABOR					9945.00	0.00	0.00	9945.00	0.00	0.00	9945.00	0.00	0.00	9945.00	0.00	0.00
ELECTRICITY, FUEL					23798.00	0.00	0.00	23798.00	2379.80	0.00	21418.20	10709.10	0.00	4759.60	5949.50	0.00
SPARE PARTS					44166.00	0.00	0.00	44166.00	2208.30	0.00	41957.70	26499.60	0.00	9716.52	5741.58	0.00
INSURANCE					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
OTHER OUTSIDE SERVICES					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
FINANCIAL COSTS					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CAPITAL RECOVERY	INVESTMEN COST	EXPECTED LIFE	ANNUITY COEFF													
factory building	479310.00	50.00	0.10		48342.81	0.00	0.00	48342.81	0.00	4834.28	43508.53	0.00	0.00	0.00	43508.53	0.00
furniture, fittings, equipment	574988.00	10.00	0.16		93576.65	0.00	0.00	93576.65	0.00	9357.66	84218.98	0.00	0.00	0.00	84218.98	0.00
TOTAL PROCESSING/MANUFACTURING COSTS					1552114.46	0.00	0.00	1552114.46	123237.27	27514.81	1401362.38	446767.55	0.00	419798.68	403362.65	131433.50
TOTAL FARM PROD + PROCESS/MANUFACTURING					1552114.46	0.00	0.00	1552114.46	123237.27	27514.81	1401362.38	446767.55	0.00	419798.68	403362.65	131433.50
COSTS OF TRANSPORT, ETC TO FOB																
STORAGE AT FACTORY					9916.00	0.00	0.00	9916.00	0.00	0.00	9916.00	0.00	0.00	0.00	0.00	9916.00
LOADING AND UNLOADING					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TRANSPORT TO PORT					4029.00	0.00	0.00	4029.00	201.45	0.00	3827.55	2417.40	0.00	886.38	523.77	0.00
STORAGE AT PORT					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PORT CHARGES					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
CAPITAL RECOVERY	INVESTMEN COST	EXPECTED LIFE	ANNUITY COEFF													
motor vehicles	174583.00	5.00	0.26		46055.08	0.00	0.00	46055.08	0.00	4605.51	41449.57	0.00	0.00	0.00	41449.57	0.00
WORKING CAPITAL																
pre-shipment	0.00	0.02	0.10		0.00											
post-shipment	1424140.00	0.25	0.10		35603.50											
TOTAL TRANSPORT, ETC COSTS					95603.58	0.00	0.00	60000.08	201.45	4605.51	55193.12	2417.40	0.00	886.38	41973.34	9916.00
TOTAL COSTS INCL. FARM PRODUCTION, PROCESSING/ MANUFACTURING, TRANSPORT, ETC.					1647718.04	0.00	0.00	1612114.54	123438.72	32120.31	1456555.51	449184.95	0.00	420685.06	445336.00	141349.50
TAX/SUBSIDY					0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL COSTS INCLUSIVE OF TAX/SUBSIDY					1647718.04	0.00	0.00	1612114.54	123438.72	32120.31	1456555.51	449184.95	0.00	420685.06	445336.00	141349.50

BREAKDOWN COEFFICIENTS:
COUNTRY: GHANA
PRODUCT: FURNITURE
FIRM: SAMPLE

	TAXES/SUBSIDIES DIRECT INPUTS TRAD.	TAXES/SUBSIDIES DIRECT INPUTS NONTRAD.	FINANCIA COST	TAXES/SUBSIDIES INDIRECT INPUTS TRAD.	TAXES/SUBSIDIES INDIRECT INPUTS NONTRAD.	ECONOMI COST	TRADABL INPUTS	.....NON-TRADABLE INPUTS..... FAMILY LABOR	HIRED LABOR	CAPITAL	LA
FARM COEFFICIENTS											
UNSKILLED LABOR			1.00			1.00			1.00		
SKILLED AND SUPERVISORY LABOR			1.00			1.00			1.00		
PLANTS, SEED, ETC	0.15	0.85	1.00			1.00	0.15		0.70	0.15	
FERTILIZERS	0.90	0.10	1.00	0.05		0.95	0.85		0.08	0.02	
INSECTICIDES, PESTICIDES	0.77	0.23	1.00	0.13	0.01	0.86	0.64		0.20	0.02	
MACHINERY SERVICES	0.65	0.35	1.00	0.05		0.95	0.60		0.22	0.13	
TRANSPORT FROM FIELD	0.65	0.35	1.00	0.05		0.95	0.60		0.22	0.13	
LAND RENT	0.00	1.00	1.00			1.00					1
CAPITAL RECOVERY											
land	0.00	1.00	1.00	0.00	0.00	1.00				1.00	
land development	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
agricultural machinery	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
irrigation installation	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
WORKING CAPITAL	0.00	1.00	1.00	0.00	0.00	1.00				1.00	
PROCESSING/MANUFACTURING COEFFICIENTS											
RAW MATERIALS-domestic	0.39	0.61	1.00	0.09	0.01	0.90	0.30		0.30	0.20	(
RAW MATERIALS-imported	0.87	0.13	1.00	0.02	0.01	0.97	0.85		0.06	0.06	
TRANSPORT TO FACTORY	0.65	0.35	1.00	0.05		0.95	0.60		0.22	0.13	
LABOR			1.00			1.00			1.00		
ELECTRICITY, FUEL	0.55	0.45	1.00	0.10		0.90	0.45		0.20	0.25	
SPARE PARTS	0.65	0.35	1.00	0.05		0.95	0.60		0.22	0.13	
INSURANCE						0.00					
OTHER OUTSIDE SERVICES						0.00					
FINANCIAL COSTS			1.00		0.10	0.90				0.90	
CAPITAL RECOVERY											
factory building	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
furniture, fittings, equip	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
COSTS OF TRANSPORT, ETC TO FOB COEFFICIEN											
STORAGE AT FACTORY	0.00	1.00	1.00			1.00					1
LOADING AND UNLOADING	0.00	1.00	1.00	0.00	0.00	1.00	0.00	0.00	1.00	0.00	
TRANSPORT TO PORT	0.65	0.35	1.00	0.05		0.95	0.60		0.22	0.13	
STORAGE AT PORT											
PORT CHARGES											
CAPITAL RECOVERY											
motor vehicles	0.00	1.00	1.00	0.00	0.10	0.90				0.90	
WORKING CAPITAL											
pre-shipment	0.00	1.00	1.00	0.00	0.00	1.00				1.00	
post-shipment	0.00	1.00	1.00	0.00	0.00	1.00				1.00	
PRODUCTION SUBSIDY											

********** ********** ********** **********

SENSITIVITY ANALYSIS + KEY PARAMETERS:

COUNTRY: GHANA

PRODUCT: FURNITURE

FIRM: SAMPLE

	--BASE CASE-- FOB	
NOMINAL PROTECTION COEFFICIENT, OUTPUTS	1.00	
NET NOMINAL PROTECTION COEFFICIENT, OUTPUTS	0.87	
NOMINAL PROTECTION COEFFICIENT, INPUTS	1.27	
NET NOMINAL PROTECTION COEFFICIENT, INPUTS	1.11	
EFFECTIVE PROTECTION COEFFICIENT	0.87	
NET EFFECTIVE PROTECTION COEFFICIENT	0.76	
EFFECTIVE SUBSIDY COEFFICIENT	0.84	
NET EFFECTIVE SUBSIDY COEFFICIENT	0.73	
DOMESTIC RESOURCE COST	0.92	
DISCOUNT RATE		10%
YIELD, FIRST PRODUCT (kg/ha)		
YIELD, SECOND PRODUCT (kg/HA)		
PROCESSING CONVERSION FACTOR, FIRST PRODUCT		
PROCESSING CONVERSION FACTOR, SECOND PRODUCT		
WORLD FOB PRICE, FIRST PRODUCT		
WORLD FOB PRICE, SECOND PRODUCT		
FACTORY GATE PRICE, FIRST PRODUCT (cedis/kg)		
FACTORY GATE PRICE, SECOND PRODUCT (cedis/kg)		
OFFICIAL EXCHANGE RATE (cedis/$)		446.00
SHADOW EXCHANGE RATE (cedis/$)		514.00
PARALLEL EXCHANGE RATE (cedis/$)		467.00
DISTANCE FIELD TO FACTORY (km)		
DISTANCE FACTORY TO PORT (km)		
TRANSPORT RATE FIELD TO FACTORY (cedis/ton-km)		
TRANSPORT RATE FACTORY TO PORT (cedis/ton-km)		

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ANNEX C: GHANA SURVEY

COSTS AND BENEFITS OF ELIMINATING INSTITUTIONAL CONSTRAINTS ON THE EXPANSION OF NONTRADITIONAL EXPORTS

SURVEY OF FIRMS IN GHANA

QUESTIONNAIRE A: FIRST INTERVIEW

General

Name of firm: _____

Industry: _____

Person (s) interviewed: _____

Position (s): _____

Interviewer: _____

Year first registered with the Registry-General: _____

Legal status (proprietorship, partnership, limited liability company): _____

Year first registered with the Ghana Export Promotion Council: _____

Brief narrative regarding history of firm, how and where it operates and, and its export experience:

Approximate value of total sales in 1992: _____ cedis

Current number of employees in production: _____ administration: _____

marketing: _____ management: _____

Annual fee paid to and services received from professional associations in 1992:

	Fee	Services
Ghana Export Promotion Council:	_____	_____
Ghana Chamber of Commerce:	_____	_____
Ghana Shippers Council:	_____	_____
_____:	_____	_____
_____:	_____	_____

Approved under Investment Code? _____ Year of approval: _____

Length of time required for approval: _____

Status (wholly Ghanaian owned, joint-venture, wholly foreign-owned): _____

_____

Benefits obtained from Investment Code status: _____

_____

At the time your firm was registered, did it acquire land? _____ Where? _____

If so, was this through sale or lease? _____

Did your firm obtain a "granting of concurrence" from the Lands Commission? _____

If so, how long did this take? _____ What problems were encountered? _____

_____

_____

_____

Did your firm register a deed or a title at the Lands Registry? _____

How long did this take? _____

Exports in:

		1991		1992	
Product	Units	Quantity	Value (cedis)	Quantity	Value (cedis)

Where are your principal export markets? _____

Do you have a foreign firm with whom you have established a close relationship? _____ If so, what is the nature of this firm

(e.g.,licensor, distributer, investor)? _____

How long has this relationship existed? _____ How was it established? _____
Does the foreign firm have a financial stake in this relationship? _____

Does the foreign firm provide you with an overseas market? _____ Foreign technology? _____

Technical assistance? _____ Management assistance? _____ Other (specify)? _____

Does the foreign firm help to ensure that your exports meet the quality standards of overseas markets? _____

Other comments:

What is the current percentage utilization of the physical capacity of your firm to produce the products listed on page? _____ Is your current capacity adequate to fill all your existing export orders? _____

If financing were available at current interest rates, would you invest in additional capacity? ___

To what extent are you constrained by the size of your overseas market? _____

_____

To what extent are you constrained by lack of good skilled workmen? _____

supervisory personnel? _____

technical personnel? _____

management personnel? _____

To what extent are you constrained by telecommunications and access to information?

_____

Export Incentives

Did you apply for duty drawback compensation in 1992? _____

If not, why not? _____

Did you receive duty drawback compensation in 1992? _____ If so, how much? _____

With what delay after you applied? _____

Did you apply for an income tax rebate for exports in 1992? _____

If not, why not? _____

Did you receive an income tax rebate for exports in 1992? _____

If so, how much? _____ With what delay after you applied? _____

Were you exempt from payment of sales and excise taxes on your locally procured inputs used to produce exported goods in 1992? _____ If not, why not? _____

Export Procedures

Please indicate any cost in terms of time, fees, and facilitating tips that you normally incur per shipment for each of the following:

Procedure	Person/Organization Responsible	Time Required for Execution	Fee Paid	Tips Paid
Income Tax Certificate	_____	_____	_____	_____
Forest Products Insp Bureau approval	_____	_____	_____	_____
Ghana Standards Board approval	_____	_____	_____	_____
Museum and Monuments Board approval	_____	_____	_____	_____
Chamber of Commerce certificate of origin	_____	_____	_____	_____
Port health certification	_____	_____	_____	_____
Plant Protection and Quarantine Certificate	_____	_____	_____	_____
Shipper Council Ad Hoc Fee	_____	_____	_____	_____
Use of forwarding agent or equivalent	_____	_____	_____	_____
Processing customs and shipping forms	_____	_____	_____	_____
Total	_____	_____	_____	_____

If the person responsible is with your firm, how much is his time worth inclusive of salary,

fringe benefits,etc.? _____

What unusual delays have you experienced in complying with export procedures and with what consequences in terms of lost contracts, reduced prices, spoiled goods, etc?

_____

_____

What is the frequency of this type of delay? _____

Other problems encountered and comments related to export procedures:

Input Supply

For each major imported input, please indicate the cost of normally importing in terms of: (1) the time of delay between the arrival of the goods at the port or airport and the time you receive them; (2) the time that you or one of your staff spends trying to clear the goods; (3) the percent tariff you pay on the goods; (4) the cost you pay to a forwarding agent; (5) other costs and fees paid:

Input	Delay	Staff Time	% Tariff	Cost of Forwarder	Other Costs

What has generally been the cause of the delays? _____

Have these delays ever had an important effect on your ability to fill an export order on time? _____
How frequently? _____ With what consequences? _____

What is the average cost of transporting inputs from the port/airport to your factory/farm? _____

Could any of these inputs be purchased from local sources? If so, which? _____

_____

How do the locally available inputs compare with those that are imported with respect to

Price? _____

Quality? _____

Availability? _____

Other comments regarding input supply:

Financing

How many export shipments did you make in 1992? _____

Were these shipments financed by a line of credit? _____

If so, with which lending institution? _____ What rate of interest did you pay? _____

What was the duration of the credit line? _____ What was the ceiling? _____

Was any collateral involved? _____ If so, what was its nature? _____

_____

Is this line of credit adequate for your working capital needs? _____ If not, what would you need? _____

To the extent that your credit was tied to specific export orders, for each type of shipment, please specify the following as typical financing:

Type of Shipment	Value of Shipment	Source of Financing	Amount Borrowed	Type of Borrowing	Duration Loan	Interest Rate (%)	Collateral	Guarantee

Problems encountered and other comments related to financing working capital:

During the past two years (1991, 1992), did you purchase or rehabilitate/develop any land, buildings, or equipment (including the planting of tree or other crops with a maturity in excess of one year? _____

If so, what was the nature of this investment?

_____

_____

_____

How was this investment financed?_____

If financed through borrowing, who was the lender? _____

What was the duration of the loan? _____. What was the rate of interest? _____

What collateral, if any, was used? _____

_____

Other problems encountered and comments related to financing fixed capital:

Do you ever borrow on the informal credit market, eg. money lenders, merchants? _____ If so, what are the average amounts borrowed and the terms of the loans (rate of interest, duration, periods of repayment, etc.)? _____

_____

How would you otherwise invest the capital that you have in your firm (eg, government securities, savings accounts) and what rate of interest would you receive? _____

_____

Packing and Shipment

Does your firm have cold storage/packing facilities for stocking/processing your product prior to export? _____ If so, where are these located? _____

Are they owned or leased? _____ Are they adequate? _____ If not adequate, why have you not expanded them? _____

If your firm does not own/lease cold storage/packing facilities, does it have access to facilities that are owned/leased by others? _____ Are these facilities adequate? _____

When you export, do you use internationally recognized grading and packaging standards? ___

If not, why not? _____

Does this reduce the price you receive? _____ Does it limit your market? _____

Are your packing materials imported or produced locally? _____

If produced locally, from what firm? _____

Are adequate cold storage facilities available at the port/airport? _____

If not, in what way are they inadequate? _____

Are adequate refrigerated containers available for sea shipment? _____

If not, what problems do you encounter? _____

_____

Do you usually ship whole are partial containers? _____ If partial, are there adequate facilities for bulking shipments? _____ Who provides these facilities? _____

Is adequate cargo space available by air? _____ By sea? _____ Overland? _____

If not, what problems do you encounter? _____

_____

Do you generally secure export insurance? _____ If no, does the importer secure? _____

If the importer secures it, at what rate by air? _____ By sea? _____

If you secure it, at what rate by air? _____ By sea? _____

What cost do you typically incur for the shipment of your exported products by air to what country? _____

By sea northbound? _____

By sea southbound? _____

Overland? _____

Have delays in obtaining cargo space or in completing export procedures ever resulted in your losing a market or suffering a reduction in price? _____ With what frequency does this occur? _____ What have been the value of the losses you have incurred relative to the value of your shipments? _____

_____

Other problems or comments related to packing and shipment.

Government Intervention

Have you ever encountered intervention on the part of the government at a high level that you felt put your investment in your firm at risk? _____ If so, please describe briefly.

Problems or Comments not Discussed Elsewhere

COSTS AND BENEFITS OF ELIMINATING INSTITUTIONAL CONSTRAINTS ON THE EXPANSION OF NONTRADITIONAL EXPORTS

SURVEY OF FIRMS IN GHANA

QUESTIONNAIRE B: FOLLOW-UP

Thank you for agreeing to participate in the second phase of our survey. This involves your filling in or helping us to fill in Questionnaire B: Follow-up. This questionnaire includes data on input costs, input prices, value of output, and capital costs. These data are extremely important in allowing us to calculate a baseline regarding the profitability of exporting and in determining the relative importance in quantitative terms of the various constraints on export growth in your industry. From these data, we hope to identify the most important constraints with a view to assisting in calling for policy changes and assistance to your sector. We are very grateful for your cooperation.

Please be assured that any information that you provide in this phase will be treated as entirely confidential. Information included in the final report will be presented in such a way as to avoid identifying in any way the firms providing the information.

If you have any questions regarding Questionnaire B, please feel free to call either Jes Posey or Joanna Arthur at Databank Ghana Limited, telephone 699110, 699417, or 669421.

Name of Firm: _____

Field Costs (per acre)	Unit	Quantity	Unit Price	Total Cost	Quantity	Unit Price	Total Cost
Product							
Unskilled labor							
Skilled and supervisory labor							
Plants, seeds, etc							
Fertilizers _____							
Insecticides, pesticides _____							
Machinery services _____							

	Unit	Quantity	Unit Price	Total Cost	Quantity	Unit Price	Total Cost
Small tools							
Transport from field							
Land rent							
Yield per acre							
Number acres/total value of crop							
Cost of Collection	Unit	Quantity	Unit Price	Total Cost	Quantity	Unit Price	Total Cost
Product							
Loading							
Transport to warehouse							
Unloading							
Storage							

Processing/Manufacturing Costs	Unit	Quantity	Unit Price	Total Cost	Quantity	Unit Price	Total Cost
Product							
Purchase produce/raw materials							
Transport to factory							
Labor							
Electricity, fuel							
Spare parts							
Insurance							
Other outside services							
Financial costs							
Quantity produced/value prod							
By-product							

Costs of Transport, etc to FOB	Unit	Quantity	Unit Price	Total Cost	Quantity	Unit Price	Total Cost
Product							
Storage at factory							
Loading							
Transport to port/border							
Unloading							
Storage							
Port charges							
Quantity/value shipped FOB							

Working Capital Costs

	Value of Capital (cedis)	Avg Time Capital Tied Up	Interest Rate	Capital Cost
Intermed inputs/raw materials				
Finished goods				
Pre-shipment				
Post-shipment				

Fixed Capital Costs

	Value of Capital (cedis)	Year of Purchase	Avg Time Capital Tied Up	Interest Rate	Capital Cost
Land purchase					
Land development					
Agricultural machinery					
Irrigation installation					
Factory building					
Factory equipment					

ANNEX D: MADAGASCAR SURVEY

COÛTS ET AVANTAGES DE L'ELIMINATION DES CONTRAINTES INSTITUTIONNELLES SUR LA CROISSANCE DES EXPORTATIONS NON TRADITIONNELLES

ENQUÊTE SUR LES ENTREPRISES MALGACHES

QUESTIONNAIRE A: PREMIER ENTRETIEN

Nom de l'entreprise: _____

Secteur d'activité: _____

Personne(s) interrogée(s): _____

Poste(s) occupé(s) _____

Enquêteur: _____

Général

Année de l'Attestation d'Inscription au Registre du Commerce: _____

Statut juridique (entreprise individuelle, association, société à responsabilité limitée, société anonyme): _____

Année du premier paiement du Taxe Professionnelle ou Patente d'Exportateur: _____

Chiffre d'affaires approximatif pour 1992: _____ FMG

Nombre d'employés travaillant actuellement à la production: _____

à l'administration: ___ à la commercialisation: ___ à la gestion: __

Exposé succinct: historique de l'entreprise, mode de fonctionnement, zone d'activité, expérience dans le domaine de l'exportation:

Programmes d'encouragement

Entreprise agrée

par le code d'investissement? _____

titre de petit et moyenne entreprise _____

titre de base _____

dans une zone franche? _____

comme entreprise franche? _____

en quelle année? _____

Statut (entreprise nationale ou étrangère, joint venture): _____

Délai d'obtention de l'agrément à partir
de la date de soumission du dossier: _____

Problèmes rencontrés dans l'obtention de l'agrément:

Avez-vous réçu le droit d'être exonéré de la TUT à cause de
l'importance de vos exportations? _____

à partir de quelle année? _____

quelle est la proportion des exportations dans votre chiffre d'affaires? _____

Avez-vous réçu de l'admission temporaire pour des produits
intermédiaires importés? _____

en quelles années _____

Quels problèmes avez-vous rencontré dans l'application de ces programmes d'encouragement?

L'Acquisition du terrain

Votre entreprise, a-t-elle acquis des terres? _____ Où? _____
Dans l'affirmative, s'agissait-il d'une vente? _____
d'un bail? _____

Si un bail, de quelle durée? _____

Est-ce que vous êtes satisfait avec cet arrangement? _____

Si non, qu'est-ce que vous préférerait?

Avez-vous déposé un dossier avec le Service des Domaines? _____

Combien de temps vous a-t-il fallu pour obtenir l'autorisation? _____

Quels problèmes sont survenus?

Votre entreprise a-t-elle un titre de propriété enregistré au Service des Domaines? _____

Combien de temps a-t-il fallu pour cet enregistrement? _____

Exportations et liens à l'extérieur

A l'ordre d'importance, quels sont vos principaux produits exportés et vers quels marchés?

Y a-t-il une entreprise étrangère avec laquelle vous avez établi des relations régulières? _____
Dans l'affirmative, quelle est la nature de cette entreprise (e.g., entreprise concédant une licence, distributeur, investisseur)? _____

Depuis combien de temps entretenez-vous ces relations? _____

Comment se sont-elles établies?

L'entreprise étrangère trouve-t-elle un intérêt financier à ces relations? _____
L'entreprise étrangère vous procure-t-elle un marché à l'étranger? _____
de l'usage de technologies? _____
de l'appui technique? _____
de l'appui de gestion? _____
d'autres avantages (préciser)?

L'entreprise étrangère vous aide-t-elle à mettre vos produits exportés au niveau des normes de qualité des marchés étrangers? _____
Autres observations en ce qui concerne vos liens à l'étranger:

Dans quelle mesure sont vos exportations limitées par vos conaissances et accès aux marchés à l'étranger?

Contraintes sur la production

Dans quelle mesure êtes-vous limité par le manque ou la qualité de travailleurs qualifiés?

de personnel d'encadrement?

de personnel technique?

de personnel administratif?

Quel pourcentage de sa capacité physique votre entreprise utilise-t-elle pour la production des produits exportés? _____
Votre capacité actuelle est-elle suffisante pour servir tout votre carnet de commandes à l'exportation? _____
Si non, est-ce que vous avez l'intention d'élargir votre capacité? _____
Quelles sont les contraintes qui vous empêchent de faire cet investissement?

Approvisionnement en intrants

Quels intrants ou produits intermédiaires importez-vous pour la production ou l'emballage de vos exportations?

Quels problèmes avez-vouz rencontré dans l'acquisition de dévises pour ces importations?

Quels délais avez vous rencontré en ce qui concerne les formalités d'importation, la disponibilité de transport, etc.

A quoi les délais sont-ils dûs en général?

Ces délais ont-ils eu des effets sérieux pour vous empêcher
de servir une commande d'exportation à la date prévue? ____
Avec quelle fréquence? ____
Quelle est votre meilleure estimation du coût annuel entrainé par ces delais?

Quelle est votre meilleure estimation du frais dépensé en argent, en temps du personnel ou en stocks supplémentaires retenus afin d'éviter les conséquences de ces delais?

Est-ce que certains de ces intrants pourraient être achetés sur place? ____

lesquels? _____

Quelle comparaison pouvez-vous faire entre les intrants disponibles sur place et ceux qui sont importés, en ce qui concerne:

le prix?

la qualité?

la disponibilité?

Autres commentaires concernant l'approvisionnement en intrants:

Formalités d'exportation

Quels retards anormaux avez-vous subis lors de l'accomplissement des formalités d'exportation, et quelles ont été les conséquences, e.g. perte de marchés, réduction de prix, détérioration de marchandises, etc.?

Avec quelle fréquence se produisent des retards de cette sorte? _____

Quelle est votre meilleure estimation du coût annuel entrainé par ces retards?

Quelle est votre meilleure estimation du frais dépensé en argent, en temps du personnel ou en stocks supplémentaires retenus afin d'éviter les conséquences de ces retards?

Autres problèmes survenus, et commentaires relatifs aux formalités d'exportation:

Emballage et expédition

Vos matériels d'emballage sont-ils importés ou produits localement? _____

si produits localement, est-ce que la qualité est satisfaisante? _____

est-ce que le fournisseur est suffisamment digne de confiance en ce concerne l'approvisionnement? _____

Expédiez-vous habituellement des containers complets ou partiels? _____

S'il s'agit des containeurs complets, ou sont-ils chargés? _____

S'il s'agit de containers partiels, y a-t-il des installations satisfaisantes pour le groupement des expéditions? _____

Qui fournit ces installations? _____

Les moyens de transport sont-ils suffisants pour le fret aérien? _____

pour le fret maritime? _____

pour les transports terrestres? _____

Au cas contraire, quels sont les problèmes qui se posent?

Est-il arrivé que les délais d'expédition aient entraîné

la perte d'un marché _____

une baisse de vos prix? _____

Avec quelle fréquence ceci se produit-il? _____

Quelle est votre meilleure estimation du coût annuel entrainé par ces retards?

Quelle est votre meilleure estimation du frais dépensé en argent, en temps du personnel ou en stocks supplémentaires retenus afin d'éviter les conséquences de ces retards?

Autres problèmes ou commentaires relatifs à l'emballage et à l'expédition.

Interventions de l'Etat

Avez-vous été témoin d'interventions, à l'échelon supérieur des pouvoirs publics, qui vous semblaient faire courir un risque à l'investissement que vous avez fait dans votre entreprise? ____

Dans l'affirmative, veuillez décrire succinctement la situation.

Problèmes ou commentaires non indiqués ailleurs

COÛTS ET AVANTAGES DE L'ELIMINATION DES CONTRAINTES INSTITUTIONNELLES SUR LA CROISSANCE DES EXPORTATIONS NON TRADTIONNELLES

ENQUÊTE SUR LES ENTREPRISES MALGACHES

QUESTIONNAIRE B: COMPLÉMENT D'INFORMATION

Nous vous remercions d'avoir accepté de participer à la deuxième phase de notre enquête. Il s'agira de remplir, ou de nous aider à remplir le questionnaire B intitulé "complément d'information". Les questions posées concernent la participation aux associations professionnelles, les quantités et les valeurs des exportations, les formalités d'exportation, l'approvisionment en intrants, le financement des exportations, l'emballage et l'expédition et les coûts de production, de collecte, de transformation, de transport et de capital. Les chiffres que vous nous fournirez seront extrêmement importants et nous permettront de déterminer quantitativement l'importance relative des diverses contraintes affectant le développement des exportations dans votre secteur d'activité. A partir des résultats de notre enquête, nous espérons cerner les contraintes les plus importantes, ce qui devrait aider à obtenir une modification de la politique économique de votre secteur. Nous vous sommes très reconnaissants de votre coopération, et vous recevrez une exemplaire de notre rapport final.

Nous nous engageons à respecter le caractère absolument confidentiel de tous renseignements fournis par vous au cours de cette phase de l'enquête. Les informations qui figureront au rapport final seront présentées de façon à rendre impossible l'identification des entreprises dont proviendront ces informations.

Si vous avez des questions à poser au sujet du questionnaire B, il vous suffira de téléphoner à l'Office Statistique et Informatique pour la Programmation de Développement (OSIPD) - 307.83.

Nom de l'entreprise: _____
Secteur d'activité: _____
Personne(s) interrogée(s): _____
Poste(s) occupé(s): _____
Enquêteur: _____

Général

Montant payé à l'année la plus récente pour
Taxe Professionnelle: _____ pour l'année: _____
Patente d'Exportateur: _____ pour l'année: _____

Prestations d'associations professionelles/agences publiques

	Cotisations	Prestations
Groupement des Entreprises Malgache	_____	_____
FIVMPAMA	_____	_____
Direction de la Promotion des Exportations	_____	_____
Centre des Techniques et des Pratiques des Exportations	_____	_____
_____	_____	_____
_____	_____	_____

Exportations en:

		1991		1992	
Produit	Unités	Quantité	Valeur (FMG)	Quantité	Valeur (FMG)

Formalités d'exportation

Veuillez indiquer tous coûts normalement entraînés par une expédition (temps passé, redevances, gratifications ou pourboires) pour chacune des formalités suivantes:

	Formalité	Personne/ organisme responsable	Temps exigé pour l'exécution	Redevance payée	Gratification remise
Remplissage Déclaration en Douane (Série E):					
Domiciliation Déclaration Exportation et Engagement de Répatriement de Devises:					
Autorisation Direction Eaux et Forêts:					
Permis Spécial Exportation CITES délivré par Direction Eaux et Fotêts:					
Certificat Origine et Salubrité délivré par Direction Peche et Aquaculture:					
Certificat Origine et Salubrité délivré par Direction Elevage:					
Autorisation Ministère chargé des Mines:					
Autorisation Ministère de la Culture:					
Autorisation Ministère de l'Intérieur:					
Certificat Phytosanitaire Ministère de l'Agriculture:					
Certificat d'Origine Chambre de Commerce (etc):					

Certificat de Contrôl et de Conditionnement:	____	____	____	____	____
Certificat Circulation Marchandises Destinées aux Pays CEE:	____	____	____	____	____
Autorisation de Sortie Ministère du Commerce:	____	____	____	____	____
Dédouanement:	____	____	____	____	____
Service transitaire:	____	____	____	____	____
Total:	____	____	____	____	____

Approvisionnement en intrants

Vous avez remis combien de dévises à votre banque en 1992? _____

en 1993? _____

Combien de devises avez-vous demandé pour l'importation des intrants

en 1992? _____ en 1993? _____

Combien de devises avez-vous réçu pour l'importation des intrants

en 1992? _____ en 1993? _____

Quel a été le délai normal pour obtenir les dévises? _____

Pour chacun des principaux intrants importés, veuillez indiquer le coût d'une importation normale en ce qui concerne: (1) délai écoulé entre l'arrivée des marchandises au port ou à l'aéroport et le moment où vous les recevez; (2) temps passé par vous ou par l'un de vos employés pour obtenir le dédouanement des marchandises; (3) pourcentage de taxe d'importation; (4) pourcentage de TUT; (4) frais payés à un transitaire ou service d'expédition; (5) autres coûts, redevances ou gratification versées:

Intrant	Délai	Personne Responsable	Temps passé	Taxe (%)	Frais de Transitaire	Autres Coûts

Financement des exportations

En ce qui concerne vos exportations, disposez-vous normalement

d'un préfinancement? _____ Taux d'intérêt ___
d'une avance sur produits? _____ Taux d'intérêt ___
d'une avance sur marchandises? _____ Taux d'intérêt ___
d'un crédit documentaire? _____ Taux d'intérêt ___
d'une remise documentaire? _____ Taux d'intérêt ___

Auprès de quel organisme de prêt? _____

S'agissait-il d'un crédit sur garantie? _____ Quelle sorte de garantie?

Disposez-vous d'une ligne de crédit? _____

Cettes lignes de crédit sont-elles suffisantes pour vos besoins de fonds de roulement?

Si elles ne sont pas suffisantes, quels seraient vos besoins?

Problèmes survenus, et autres observations relatives au financement du fonds de roulement:

Investissements

Au cours des dernières années (1991-1993), avez-vous acheté ou réhabilité/valorisé des terres, des bâtiments ou des matériels (y compris plantation d'arbres ou d'autres plantes ayant une période de maturation supérieure à un an)? _____

Dans l'affirmative, quelle était la nature de cet investissement?

Comment cet investissement a-t-il été financé?

S'il s'agissait d'un emprunt, quel était le prêteur? _____

Quelle était la durée du prêt? _____

Quel était le taux d'intérêt? _____

Quels biens ont, le cas échéant, servi de garantie ou de nantissement?

Problèmes survenus et observations relatives au financement d'immobilisations:

Vous arrive-t-il d'emprunter sur le marché informel du crédit,
par exemple à des prêteurs sur gages ou à des marchands? _____

Dans l'affirmative, quel est en moyenne le montant des emprunts, et quelles sont les conditions (taux d'intérêt, durée du prêt, échéances de remboursement, etc.)?

Quels investissements alternatifs pourriez-vous faire du capital investi dans votre entreprise (par exemple Bons du Trésor, comptes d'épargne) et quel taux d'intérêt toucheriez-vous?

Emballage et expédition

Votre entreprise possède-t-elle des installations frigorifiques pour le stockage et le conditionnement de votre production avant exportation? _____
Des magazins nonréfrigerés? _____
Si oui, où se trouvent ces installations ou magazins? _____
En êtes-vous propriétaire ou locataire? _____
Sont-elles suffisantes? _____

Si elles ne vous suffisent pas, pourquoi ne les avez-vous pas agrandies?

Si votre entreprise ne possède pas d'installations frigorifiques ou de magazins pour le stockage et le conditionnement, a-t-elle accès à des installations que possèdent ou louent d'autre entreprises? _____

Ces installations correspondent-elles à vos besoins? _____

Est-ce que le port ou l'aéroport dispose d'entrepôts frigorifiques satisfaisants? _____

Au cas contraire, quel est le défaut de ces entrepôts?

Y a-t-il des containeurs réfrigérés satisfaisants pour les transports maritimes? _____
Au cas contraire, quels sont les problèmes qui se posent?

L'assurance à l'exportation est-elle généralement à votre charge? _____
à la charge de l'importateur? _____

Quel est le tarif d'assurance

pour les transports aériens? _____
pour les transports maritimes? _____

Quel est le coût de frêt normal de l'expédition des produits que vous exportez:

frêt maritime: _____
vers quel pays? _____

frêt maritime: _____
vers quel pays? _____

frêt aérien: _____
vers quel pays? _____

frêt aérien: _____
vers quel pays? _____

QUESTIONNAIRE C: COUTS DES AFFAIRES

Coûts agricoles (par hectare)	Unité	Quantité	Prix unitaire	Coût total	Quantité	Prix unitaire	Coût total
Produit:			_____			_____	
Main-d'oeuvre non spécialisée	___	_____	_____	_____	_____	_____	_____
Personnel spécialisé et d'encadrement	___	_____	_____	_____	_____	_____	_____
Plants, semences etc.	___	_____	_____	_____	_____	_____	_____
Engrais	___	_____	_____	_____	_____	_____	_____
Produits phytosanitaires	___	_____	_____	_____	_____	_____	_____
Services de mécanisation	___	_____	_____	_____	_____	_____	_____
Petits outils	___	_____	_____	_____	_____	_____	_____
Transport après récolte	___	_____	_____	_____	_____	_____	_____
Loyer des terres	___	_____	_____	_____	_____	_____	_____
Rendement à l'hectare	___	_____	_____	_____	_____	_____	_____
Nombre d'hectares/valeur totale de la récolte	___	_____	_____	_____	_____	_____	_____

Coûts de collecte	Unité	Quantité	Prix unitaire	Coût total	Quantité	Prix unitaire	Coût total
Produit:			_____			_____	
Chargement	___	_____	_____	_____	_____	_____	_____
Transport jusqu'à l'entrepôt	___	_____	_____	_____	_____	_____	_____
Déchargement	___	_____	_____	_____	_____	_____	_____
Stockage	___	_____	_____	_____	_____	_____	_____

Coûts de transformation, fabrication ou condittionment

	Unité	Quantité	Prix unitaire	Coût total	Quantité	Prix unitaire	Coût total
Produit:			_____			_____	
Achat de produits agricoles/matières premières	___	_____	_____	_____	_____	_____	_____
Transport jusqu'à l'usine	___	_____	_____	_____	_____	_____	_____
Main-d'oeuvre	___	_____	_____	_____	_____	_____	_____
Electricité, carburant	___	_____	_____	_____	_____	_____	_____
Pièces de rechange	___	_____	_____	_____	_____	_____	_____
Assurance	___	_____	_____	_____	_____	_____	_____
Autres services extérieurs	___	_____	_____	_____	_____	_____	_____
Coûts financiers	___	_____	_____	_____	_____	_____	_____
Quantité produite/ valeur de la production	___	_____	_____	_____	_____	_____	_____
Sous-produits:							
_____	___	_____	_____	_____	_____	_____	_____
_____	___	_____	_____	_____	_____	_____	_____

Coûts de transport etc.
jusqu'à FOB

	Unité	Quantité	Prix unitaire	Coût total	Quantité	Prix unitaire	Coût total
Produit:			_____			_____	
Stockage en usine	___	_____	_____	_____	_____	_____	_____
Chargement	___	_____	_____	_____	_____	_____	_____
Transport jusqu'au port/frontière	___	_____	_____	_____	_____	_____	_____
Déchargement	___	_____	_____	_____	_____	_____	_____
Stockage	___	_____	_____	_____	_____	_____	_____
Frais portuaires	___	_____	_____	_____	_____	_____	_____
Quantité/valeur expédiée FOB	___	_____	_____	_____	_____	_____	_____

Coûts de fonds de roulement

	Valeur du capital (en FMG)	Durée moyenne d'immobilisation	Taux d'intérêt	Coût d'investissement
Intrants intermédiaires/ matières premières				
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
Produits finis avant expédition				
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
après expédition				
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Coûts d'immobilisation

	Valeur de l'immobilisation (en FMG)	Année de l'achat	Durée moyenne d'immobilisation	Taux d'intérêt	Coût d'investissement
Achat de terres					
Mise en valeur de terres					
Matériel agricole					
Aménagements d'irrigation					
Construction d'usines					
Equipement industriel					
Equipement technologique					