SOUTH AFRICA
TRADE AND INVESTMENT POLICY SECRETARIAT
AND
U.S. AGENCY FOR INTERNATIONAL DEVELOPEMNT

EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH

(PROJECT EAGER)

WORKSHOP

Glenburn Lodge
Muldersdrift, South Africa

February 4-6, 1998

PRELIMINARY AGENDA

(Version 10:00 p.m., Tues., 3 Feb. 1998)

TUESDAY, FEBRUARY 3

18:00-19:30 REGISTRATION
19:30-20:00 MEETING OF PARTICIPANTS

WEDNESDAY, FEBRUARY 4: PROJECT EAGER: RESEARCH AND POLICY WITH APPLICATION TO SOUTH AFRICA

08-30-09:00 **REGISTRATION**
09:00-10:00 **OPENING SESSION**
Chair: Prof. Rashad Cassim [Director, Trade and Industrial Policy Secretariat (TIPS)]
Rapporteur: Dr. Abdoul Barry [AIRD, USA]
Welcome and Opening Remarks: Prof. Rashad Cassim [TIPS]
Overview of EAGER:
Dr. Dirck Stryker [AIRD, USA, Chief of Party, EAGER/Trade] and
Dr. Clive Gray [HIID, USA, Chief of Party, EAGER/PSGE]
Ms. Rita Aggarwal [Economist, Africa Bureau, USAID/Washington]
USAID Welcome: Mr. Aaron Williams, Director, USAID/South Africa

10:00-10:30 Coffee Break

10:30-12:30 **SUMMARY OF EAGER RESEARCH**
Chair: Rashad Cassim [TIPS]
Rapporteur: Dr. Abdoul Barry [AIRD, USA]
Presenters: Dr. Dirck Stryker [AIRD, USA]
Dr. Clive Gray [HIID, USA]

12:30-14:00 Lunch

14:00-16:00 **POLICY MAKING, THE PRIVATE SECTOR, AND THE ROLE OF ECONOMIC RESEARCH**
Chair: Dr. Ashgar Adelzadeh [NIEP]
Rapporteur: Prof. William Masters [Purdue Universty, USA]
Panel: Mr. Hamet Ndour (REMIX, Senegal)
Mr. Neal Cohen (USAID/REDSO/East, Kenya)

16:00-16:30 Coffee Break

16:30-18:00 **CURRENT ISSUES IN THE SOUTH AFRICAN ECONOMY**
Chair: TBA
Rapporteur: Dr. Malcolm McPherson [Senior Advisor, EAGER/PSGE, HIID, USA]
Panel: Dr. Ashgar Adelzadeh [NIEP]
Dr. Neva Makgetla [Dept. of Public Service and Administration]
Dr. Rashad Cassim [TIPS – South Africa].

18:30- 19:30 **EAGER AND THE INTERNET:** Live Demonstration of the World Wide Web and the Use of E-Mail
Demonstrator: Dr. Djimé Adoum [BHM, USA]

THURSDAY, FEBRUARY 5: SESSIONS ON EAGER RESEARCH THEMES

09:00-10:30 ***PLENARY SESSION*: RESTARTING AND SUSTAINING GROWTH AND DEVELOPMENT IN AFRICA**

Chair: Dr. Daniel Ndlela [Zimconsult, Zimbabwe, Regional Coordinator for East and Southern Africa, EAGER/Trade]

Rapporteur: Prof. Donald Mead [Michigan State University, USA]

Presenters: Dr. Ngure Mwaniki [MA Consulting Group, Kenya]; Prof. Abdoulaye Diagne [CREA, Senegal]; Dr. J. C. Munene [MISR, Uganda]; Dr. Malcolm McPherson, Dr. Arthur Goldsmith, and Dr. Clive Gray [all HIID, USA]

Discussant: Dr. Diery Seck [IDRC, Senegal]

10:30-11:00 Coffee Break

PARALLEL SESSIONS:

11:00-12:30 **GLOBAL TRADE ANALYSIS FOR SOUTHERN AFRICA**

Chair: Dr. Temba Mhlongo [DTI]

Rapporteur: Dr. Daniel Ndlela [Zimconsult, Zimbabwe]

Presenters: Prof. William Masters [Purdue University, USA] Global Trade Analysis for Southern Africa

Prof. Inyambo Mwanawina [University of Zambia, Zambia], The Impact of Capital Flows to South Africa

Prof. Robert Davies [University of Zimbabwe, Zimbabwe], The Impact of SA-EU and SADC Free-Trade Agreements

Discussant: Prof. Dominique Njinkeu [AERC, Kenya]

11:00-12:30 **BARRIERS TO AGRICULTURAL TRADE**

Chair: Dr. Dunstan Spencer [Dunstan Spencer Associates, Sierra Leone, Regonal Coordinator for West and Central Africa, EAGER/Trade]

Rapporteur: Prof. Lucie Phillips [IBI, USA]

Presenter: Dr. Fred Opio [EPRC, Uganda], Comparative Advantage and Intra-Regional Trade for Uganda's Low Value Non-traditional Export Crops: the Case of Maize and Beans

Discussant: Mr. Neal Cohen (USAID/REDSO, Kenya]

Presenter: Dr. Abdoul Barry [AIRD, USA], Promotion of Mali's Rice Exports Towards the West African Regional Market

Dr. Abdoul Barry [AIRD, USA], Impact of Adjustment on Agricultural Competitiveness and Regional Trade in Sahelian West Africa

Discussant: Prof. Abdoulaye Diagne [CREA, Senegal]

11:00-12:30 **LEGAL-REGULATORY-JUDICIAL (LRJ) REFORMS AND GOVERNANCE**

Chair: TBA

Rapporteur: Dr. Arthur Goldsmith {HIID, USA]

Presenter: Prof. Patrick Meagher [IRIS, USA] and Dr. Haji Semboja [ESRF, Tanzania], Business Contracting Practices in Tanzania

12:30-14:00 Lunch

14:00-15:30	**TAX POLICY REFORM**
Chair:	Dr. Diery Seck {IDRC, Senegal]
Rapporteur:	Dr. Eric Nelson [DAI, USA]
Presenters:	Dr. Pepe Andrianomanana [CEE, Madagascar] and Dr. Clive Gray [HIID, USA], Enhancing Transparency in Tax Administration
Discussant:	Prof. Arthur Goldsmith [University of Massachusett/Boston, USA]
Presenters:	Dr. Pepe Andrianomanana [CEE, Madagascar] and Mr. Jean Razafindravonona [EPM, Madagascar], Tax Policy in Sub-Saharan Africa: The Role of Excise Taxes
Discussant:	Mr.Daniel Ramarokoto [Executive Secretary, Secretariat Technique de l'Ajustement (STA), Madagascar]
14:00-15:30	**PROMOTING AN ENVIRONMENT FOR PRIVATE SECTOR ACTIVITY**
Chair:	Dr. Ngure Mwaniki [M.A. Consulting Group, Kenya]
Rapporteur:	Prof. Patrick Meagher [IRIS, USA]
Presenters:	Dr. Polycarp Musinguzi [BOU, Uganda] and Dr. Marios B. Obwona [EPRC, Uganda], Monetary and Exchange Rate Policy in Uganda
Discussant:	Dr. Andrew Bvumbe [Reserve Bank of Zimbabwe, Zimbabwe]
Presenter:	Prof. Germina Ssemogerere [Makerere University], Industrial Competitiveness in Kenya and Uganda
Discussant:	Prof. Margaret McMillan [IBI, USA]
14:00-15:30	**LABOR MARKETS, EMPLOYMENT, AND PRODUCTIVITY IN SOUTH AFRICA**
Chair:	Prof. Rashad Cassim {TIPS]
Rapporteur:	Prof. Robert Davies [University of Zimbabwe]
Presenters:	Prof. Fuad Cassim [University of Witwatersrand, South Africa] and J. Dirck Stryker [AIRD, USA], Increasing Labour Demand and Productivity in South Africa
Discussant:	Prof. Donald Mead [Michigan State University, USA]
Presenter:	Ms. Lynn Salinger [AIRD, USA], Dr. Haroon Bhorat [UCT], and Mr. Malcom Keswell [University of Natal/Durban], South Africa: Potential, Constraints, and Comparative Advantage in the Textiles and Clothing Subsector
Discussant:	Ms. Keryn House [DTI}
15:30-16:00	Coffee Break
16:00-17:30	**CREATING A NETWORK OF POLICY RESEARCH IN AFRICA**
Chair:	Mr. Richard Harber, Economist, USAID/South Africa
Rapporteur:	Prof. Lynn Salinger [AIRD, USA]
Panel:	Dr. Diery Seck [IDRC, Senegal] Prof. Rashad Cassim [TIPS] Prof. Abdoulaye Diagne [CREA, Senegal] Dr. Fred Opio [EPRC, Uganda] Dr. Dirck Stryker [AIRD, USA] Dr. Clive Gray [HIID, USA]
18:00-21:00	**RECEPTION**

FRIDAY, FEBRUARY 6 AM: *PARALLEL SESSIONS ON RESEARCH THEMES:*

08:00-09:00 **GLOBAL TRADE ANALYSIS SOFTWARE DEMONSTRATION**
Demonstrator: Prof. William Masters [Purdue University, USA]

11:00-12:30 **CONTRIBUTION OF BUSINESS LINKAGES TO THE GROWTH OF PRODUCTIVE EMPLOYMENT AMONG MICRO AND SMALL ENTERPRISES IN SOUTH AFRICA**
Chair: Dr. John Munene [Makerere Institute for Social Research, Uganda]
Rapporteur: Dr. Dunstan Spencer [Dunstan Spencer Associates, Sierra Leone]
Presenters: Ed Bbenkele [Univ. of Natal/Pietermaritzburg, S. Africa], Owen Skae [Univ. of Natal/Durban, S. Africa], Francis Anim [Univ. of the North, S. Africa], and Donald Mead [Michigan State Univ., USA]
Discussant: Mr. Bala Rajaratnam [Ntsika, South Africa]

09:00-10:30 **REFORMING FINANCIAL MARKETS IN SUB-SAHARAN AFRICA**
Chair: Dr. Andrew Bvumbe [University of Zimbabwe]
Rapporteur: Dr. Polycarp Musinguzi [Bank of Uganda, Uganda]
Presenter: Prof. Samuel Ziorklui [Howard University, USA], The Impact of Finacial Sector Reform on Bank Efficiency and Financial Deepening for Savings Mobilization in Ghana
Presenter: Prof. Sam Ziorklui [Howard Univ., USA], The Development of Capital Markets and Growth in Sub-Saharan Africa
Discussant: Dr. Eric Nelson [DAI, USA]

09:00-10:30 **AFRICAN TRADE AND INVESTMENT IN RELATION TO THE GLOBAL ECONOMY**
Chair: Dr. Fred Opio [EPRC, Uganda]
Rapporteur: Dr. Abdoul Barry [AIRD, USA]
Presenter: Prof. Margaret McMillan [IBI, USA] and Dr. Marios Obwona [EPRC, Uganda], Foreign and Local Investment in Africa
Discussant: Prof. Germina Ssemogerere [University of Makerere, Uganda]
Presenter: Ms. Lynn Salinger [AIRD, USA], Transshipment of Textiles and Clothing Through Africa
Discussant: Dr. Daniel Ndlela [Zimconsult, Zimbabwe]

10:30-11:00 Coffee Break

09:00-10:30 **ELECTRICITY TRADE IN THE SOUTHERN AFRICA POWER POOL**
Chair: Dr. William Lyakurwa [AERC, Kenya]
Rapporteur: Prof.Dominique Njinkou [AERC, Kenya]
Presenters: Prof. William Masters [Purdue University, USA] and Mr. Ferdi Kruger [ESKOM, South Africa]
Discussants: Prof. Rob Davies [University of Zimbawe]
Prof. Inyambo Mwanawina [University of Zambia]

11:00-12:30 **FINANCIAL INTERMEDIATION FOR THE POOR**
Chair: TBA
Rapporteur: Prof. Margaret McMillan [IBI, USA]
Presenters: Dr. Hamed Ndour [REMIX, Senegal], Dr. Mohammed Karaan [University of Stellenbosch] and Dr. Eric Nelson [DAI, USA] Financial Intermediation for the Poor in Senegal and South Africa
Discussant: Dr. Fred Opio [EPRC, Uganda]

12:30-14:00 Lunch

FRIDAY, FEBRUARY 6, PM: ***SUMMARY AND CONCLUSIONS***

14:00-15:30 **SUMMARY OF PARALLEL SESSIONS AND CLOSURE OF WORKSHOP**

15:30-16:30 **GLOBAL TRADE ANALYSIS SOFTWARE DEMONSTRATION**
Demonstrator: Prof. William Masters [Purdue University, USA]

16:00-19:00 **MEETING OF RESEARCH TEAMS WITH EAGER/TRADE TECHNICAL COMMITTEE**

SATURDAY, FEBRUARY 7: ***MEETING OF RESEARCH TEAMS WITH EAGER/TRADE TECHNICAL COMMITTEE***

Report Folder "B"

Papers and Reports from South Africa Workshop

EAGER WORKSHOP REPORTS, JOHANNESBURG, SOUTH AFRICA
February 4-6, 1998

1. Amelioration De La Transparence Dans L'Administration Fiscale: Pays e'tudle': Madagascar by *Pepe Andrianomanana, Henri Ranaivosolofo, Louis Rajaonera, Claude Rakotoarisoa*

2. Comparative Advantage and Intra-Regional Trade for Uganda's Non Traditional Export Comodities: The Case of Uganda, Kenya, Tanzania and Rwanda - Proposal for a Research Study *by Fred Opio and Marios Obwona*

3. Competitiveness of Uganda's Manufacturing Sector: The Current State and Prospects by *Dr. G. Ssemogerere*

4. Contracting in Tanzania *by Satu Kahkonen and Patrick Meagher*

5. The Contribution of Business Linkages to The Growth of Productive Employment Among SMMES in South Africa: Approaches and Principal Findings To Date *by Francis Amin, Edwin Chookole, Donal C. Mead and Owen Skae*

6. The Development of Capital Markets And Growth in Sub-Saharan Africa - Research Proposal Final Design *by Dr. Sam Q. Ziorklui and Dr. Lemma W. Senbet*

7. Editorial Guidelines for Eager Research Documents by BHM International

8. Enhancing Transparency in Tax Administration: Discussion Paper; United States Practice in Estimating and Publicizing Tax Evasion *by Clive Gray*

9. Financial Intermediation and Poverty in Senegal *by Hamet Ndour and Aziz Wane*

10. Financial Intermediation for the Poor: South African Case Study *by Nick Vink, Mohammad Karaan, Catherine Cross*

11. Fiscal Policy In Sub-Saharan Africa: A Fresh Outlook on The Role of Excise Tax - Case Study Madagascar *by Henri Ranaivosolofo, Suzanne Rabetokontany, Lois P. Ranariamarolaza, Pepe Andrianomanana, Jean Razafindravonona*

12. Global Trade Analysis for Southern Africa: The Resource Allocative Effects of Free Trade Areas in Southern Africa *by Rob Davies, University of Zimbabwe*

13. Global Trade Analysis for Southern Africa: The Impact of Capital Flows into South Africa by *Inyambo Mwanawina, University of Zambia*

14. Increasing Employment and Labor Productivity in South Africa: Progress Report *by J. Dirck Stryker, Faud Cassim, Haroon Bhorat and Bala Rajaratnam*

15. The Impact of Financial Sector Reform on Bank Efficiency and Financial Deepening for Savings Mobilization in Ghana *by Dr. Sam Q. Ziorklui and Dr. Fritz Gockel*

16. Improving Transparency in Tax Administratio: Case Study - Madagascar *by Pepe Andrianomanana, Henri Ranaivosolofo, Louis Rajaonera*

17. Intermediation Financiere & Pauvrete Au Senegal Document ½

18. La Politique Fiscale En Afrique Subsaharienne: Un Nouvel Examen Du Role Des Droits Daccises *by Henri Ranaivosolofo, Suzanne Rabetokontany, Lois P. Ranariamarolaza, Pepe Andrianomanana, Jean Razafindravonona*

19. Promoting the Competitiveness of Textiles and Clothing Manufacture in South Africa *by Lynn Salinger, Haroon Bhorat, Diane Flaherty and Malcolm Keswell*

20. Relance De La Croissance Et Developpement Durable En Afrique

21. Restarting and Sustaining Growth and Development in Africa: An Overview of the Institutional Dimension *by Arthur A. Goldsmith*

22. Restarting and Sustaining Growth and Development in Africa: Country Study - Senegal: Scope of Work

23. Study On Business Contracting Practices In Tanzania *by Samuel M. Wangwe, Semboja H. Haji and Ayubu Nyanga*

24. Study on Restarting and Sustaining Growth and Development in Africa: Kenya Country Study (Draft Scope of Work) by M.A. Consulting Group, Nairobi

EAGER / PSGE

AMELIORATION DE LA TRANSPARENCE DANS L' ADMINISTRATION FISCALE

Pays étudié : Madagascar

Principales conclusions de l'étude

Equipe de recherche :

- **ANDRIANOMANANA Pépé**
- **RANAIVOSOLOFO Henri**
- **RAJAONERA Louis**
- **RAKOTOARISOA Claude**

janvier 1998

Rappel de l'objectif de la recherche :

Dans la définition et la mise en ocuvre d'une **politique favorable à la croissance et à l'équité**, il est nécessaire, s'agissant de la gestion de l'équilibre interne, d'accorder de l'importance à la maîtrise du déficit fiscal.

Dans le cadre de la présente recherche, la maîtrise du déficit fiscal est étudiée du côté recettes. Dans le cas de Madagascar, une telle approche est d'autant plus indiquée que le pays connait, depuis quelques années une baisse tendancielle, et prononcée, de la performance fiscale.

L'objectif est de contribuer à l'amélioration de la performance de l'Administration fiscale.
Une telle amélioration suppose des réformes du système fiscal et le renforcement de l'Administration fiscale. Les différentes options relatives à ces aspects ne sont pas directement explorées dans cette étude.

L'aspect ici ciblé est le renforcement de la **transparence de l'Administration fiscale**. A cet effet, on fait l'hypothèse suivante : des informations suffisantes, données au public, sur la nature de la faiblesse de l'Administration fiscale et l'étendue de l'évasion fiscale, entraineraient une augmentation du "consentement fiscale" et une amélioration de la performance de ladite Administration.

Le rapport final est structuré en sept parties :

1) *La première partie fait le point sur les récentes études sur la fiscalité malgache*, dans le but de rappeler les principaux facteurs de déclin de la performance fiscale . Il en ressort que le taux de prélévement global (rapport de la somme des prélévements fiscaux et parafiscaux et le PIB) est passé de 14,6% en 1987, à 8,4% en 1995, et que les principaux facteurs du déclin des recettes fiscales sont :

- La suppression des taxes à l'exportation, se traduisant par une "perte" de recettes fiscales de 4 à 5% du PIB ; cette suppression n'a pas été coordonnée avec une amélioration du rendement des taxes internes ;

- Les défaillances de l'Administration relatives aux impôts à rôles
Il s'agit de l'IBS(Impôt sur les bénéfices des société) et de l'IGRNS(Impôt général sur les revenus non salariaux) qui sont des impôts directs. Les principales défaillances sont : faible couverture des contribuables, non seulement du secteur informel, mais aussi du secteur formel ; incapacité de contrôler les déclarations, alors que les sousestimations des revenus sont notoires.

- *Les défaillances de l'Administration en matière de recouvrement des impôts indirects : la TUT(Taxe* unique sur les transactions) qui a les caractéristiques de la TVA et les TC(Taxes de consommation) qui sont des droits d'accise.
Le Service des contributions indirectes, comme celui des contributions directes, n'a les moyens voulus ni de relancer tous les défaillants, ni de contrôler les déclarations des redévables.

En outre, les multiples exonérations compliquent la gestion de ces impôts et affectent leur rendement.

L'Admnistration a réagi à la tendance à la baisse des rendements en augmentant progressivement les taux de taxation. Les taux élévés de taxation semblent avoir accentué la fuite devant l'impôt.

- La faiblesse des moyens et de l'organisation de l'Admnistration fiscale
Les défaillances ci-dessus s'expliquent par la faiblesse des moyens de l'Administration fiscale (et

douanière), l'inadéquation de son organisation au niveau central, et la complexité du système fiscal.

2) La deuxième partie est relative aux estimations de l'évasion fiscale : Les limites des méthodes actuelles de prévision budgétaire pratiquées par l'Administration sont analysées ; sont, ensuite, présentées deux méthodes d'"estimations indépendantes" de l'évasion fiscale :

- Les méthodes de projection de l'Administration se réfèrent aux grandes catégories économiques et non à leurs dénominations fiscales légales. Ces grandes catégories de recettes sont:

(i) pour les recettes internes:
- les impôts sur revenus et gains(IRG)
- les impôts sur biens et services(IBES)

(ii) pour les recettes externes:
- les droits et taxes à l'exportation(DTE)
- les droits et taxes à l'importation(DTI)

Leurs évolutions sont calquées sur celle du PIB ou celle de l'indice des prix. Par exemples :

IRG= PIBCF * K, $0.015 < K < 0.018$, où le PIBCF est le PIB au coût des facteurs, et K les recettes antérieures IRG en % du PIB.
Cette méthode conduit à entériner la baisse de la performance fiscale, et reporter sur l'année N les évasions fiscales des années N-1, N-2, N-3.
Les projections des DTI et des DTE, calquées sur les projections des importations et des exportations de l'année considérée, sont plus proches des réalités.

- Une "estimation indépendante" des évasions fiscales, concernant l'année 1994, est présentée dans le rapport. Le terme "indépendant" se refère à une estimation basée sur des données de la comptabilité macroéconomique, et non à partir des données fournies par cette Administration. A cet égard, l'estimation à travers un modèle EGC(2.2) est.

Elle s'appuye sur la comptabilité nationale (avec un retour constant sur les comptes de base de 1984, les seuls disponibles avant la finition de la refonte en cours), et les données de l'"Enquête industrielle-Exercice 1994", réalisée par le projet MADIO[1].

Compte tenu de la disponibilité des données, l'estimation porte sur les instruments fiscaux suivants :

[1] MADIO, "Madagascar-Dial-Instat-Orstom", est un projet d'appui à l'Instat, bénéficiant de financements extérieurs.

- l'IBS (Impôts sur les bénéfices des sociétés)
- l'IGRNS (Impôts généraux sur les revenus non salariaux)
- la TST (taxe sur les transactions)
- la TUT intérieure,
- la TUT extérieure, et
- les Taxes d'importation, y compris les droits de douane

On peut lire sur le Tableau 1 ci-après que les recouvrements théoriques (tenant compte des exonérations légales) attendus étaient de 1371.6 milliards. Les réalisations effectives s'élevaient à 568.6 milliards ; l'évasion fiscale pour les instruments fiscaux étudiés (taxes internes et externes) est estimée, pour l'année 1994, à 803 milliards, équivalent à 8.8% du PIB. On peut rappeler que les instruments non pris en compte sont, notamment, les impôts sur les salaires, les impôts sur la propriété, les taxes de consommation (y compris celles recouvrées par la RMMF), et la TUPP.

Table 1 - ESTIMATED EVASION OF CERTAIN TAXES IN MADAGASCAR, 1994

(billions of Malagasy francs (MF), except percentages)

Type of tax	Tax rate: Industry	Tax rate: Services	Tax rate: Others	Theoretical base: Industry	Theoretical base: Service	Theoretical base: Total	Theoretical receipts: Industry	Theoretical receipts: Service	Theoretical receipts: Total, with or without exemptions: W.o.	Theoretical receipts: Total, with or without exemptions: With	Actual receipts	Evasion: MF	Evasion: Percentages of theor. rects	Evasion: Percentages of GDP	Effective tax rate
DOMESTIC TAXES															
Tax on company profits (IBS)	35%	45%		160	585	745	58	263	319	319	69	251	78.5%	2.7%	9.2%
VAT (TUT)	15%	15%		245	1010	1254	37	151	341	188	118	70	37.1%	0.8%	9.4%
Transactions Tax (TST	7%	11%	7%	895	1339	2234	63	147	210	210	59	151	71.8%	1.7%	2.6%
General tax on non-wage income (IGRNS)	25%	25%		89	472	561	22	118	140	140	9	131	93.8%	1.4%	1.6%
Sub-total, domestic taxes				1388	3406	4794	177	680	1010	858	255	603	70.3%	6.8%	5.3%

	Tax rate: Raw mats.	Tax rate: Non-food consump goods	Tax rate: Capital goods	Theoretical base: Raw mats.	Theoretical base: Non-food consum goods	Theoretical base: Capital goods	Theoretical base: Total	Theoretical receipts: Raw mats.	Theoretical receipts: Non-food consump goods	Theoretical receipts: Capital goods	Theoretical receipts: Total, with or without exemptions: W.o.	Theoretical receipts: Total, with or without exemptions: With	Actual receipts	Evasion: MF	Evasion: Percentages of theor. rects	Evasion: Percentages of GDP	Effective tax rate
TAXES ON FOREIGN TRADE																	
VAT (TUT)	15% [of all taxable imports, including import taxes & customs duties]						1336				318	200.4	143	58	28.7%	0.6%	10.7%
Import levies (import taxes & customs duties)	10%	30%	20%	345	329	441	1115	34	99	88	364	221	157	65	29.2%	0.7%	14.1%
Export levies (DTE) levy per kg. vanilla	$20			261			261	95			95	95	14	80	84.9%	0.9%	5.5%
Sub-total, taxes on foreign trade							2711				777	516	314	202	39.2%	2.2%	11.6%
TOTAL, DOMESTIC & FOREIGN TRADE TAXES							7505				1787	1374	569	805			
TOTAL AS % OF GDP = 9131															58.6%	8.8%	7.6%

3) La troisième partie est consacrée aux impôts fonciers : analyse, d'une part, des caractéristiques de la fiscalité foncière à Madagascar ; présentation, d'autre part, des résultats d'une mini-enquête sur l'attitude des contribuables vis à vis de ces impôts dans la ville d'Antanarivo ;

- La fiscalité foncière applicable à Madagascar est constituée par trois principaux impôts : *l'impôt foncier* sur les terrains (IFT), l'impôt foncier sur les propriétés bâties (IFPB) et la taxe annexe à l'impôt foncier sur les propriétés bâties (TAFPB). Ce sont des *impôts directs annuels dont les produits sont destinés à* alimenter les caisses des collectivités locales. Ils nécessitent des déclarations annuelles faites par les contribuables. Ce système déclaratif favorise l'*évasion fiscale* par :
  - la minoration des valeurs ou des loyers ;
  - Le non accomplissement systématique des obligations de déclaration par les contribuables
  - L'insuffisance des recensements fiscaux : A Antananarivo, les derniers recensements datent de 1975 ;
  - La complexité du système de recouvrement : Le recouvrement de l'impôt incombe au service du Trésor en collaboration avec les services municipaux, tandis que l'établissement de l'assiette revient au service des impôts. Les agents municipaux sont mis à la disposition des percepteurs du Trésor pour distribuer les avis d'imposition et les actes de poursuite. Ainsi, le recouvrement des impôts fonciers implique une multitude d'intervenants dont les actions ne sont pas toujours coordonnées

- La mini-enquête, effectuée auprès de 300 personnes, locataires et propriétaires disséminés à travers les divers quartiers de la capitale, devait permettre de connaître dans un premier temps, le niveau d'informations et de conscience fiscales en matière de fiscalité foncière et dans un second temps la perception et les aspirations du contribuable en matière d'impôts fonciers :
La majorité ont déclaré accomplir régulièrement leur déclarations fiscales, payer régulièrement leurs impôts fonciers ; aux questions sur les les catégories de contribuables les plus enclins à la fraude fiscale et sur les impôts les plus fraudés, les réponses diffèrent sensiblement selon les catégories sociales.
L'analyse comparative des *montants de loyers d'immeubles* obtenus à partir des enquêtes et des montants de loyers déclarés par les propriétaires auprès de l'administration fiscale au titre de l'impôt foncier donne *des informations plus intéressantes, plus parlantes* :

	Loyer moyen annuel d'après enquêtes	Loyer moyen annuel d'après déclarations fiscales
Quartiers populaires	881.579 Fmg	414.242 Fmg
Quartiers intermédiaires	1.800.000 Fmg	945.070 Fmg
Quartiers résidentiels	6.743.333 Fmg	2.571.000 Fmg

4) La législation et la pratique des exonérations fiscales font l'objet de la quatrième partie du rapport :

- Les exonérations fiscales, généralement établies pour des raisons économiques(favoriser certaines opérations ou activités) ou sociales(protéger certaines catégories de contribuables), affectent les différentes catégories d'impôts, à savoir les impôts sur les revenus, les impôts sur biens et services, et les droits et taxes sur le commerce extérieur ; auxquelles il faut ajouter les exonérations prévues par le Code des investissements et le régime des zones franches industrielles. Certaines exonérations résultent, enfin de l'application de conventions bilatérales ou multilatérales.

L'évolution récente de la législation en la matière est marquée par la prise des mesures suivantes :
- la suppression des exonérations en matière de revenus financiers dans le cadre de l'IBS en 1994 ;
- l'abrogation du Code des Investissements en 1996 ;
- l'application du taux minimum de 1 % sur les zones franches ;
- la réforme des textes sur la TVA entrainant une reduction sensible de la liste des produits exonérés, et la suppression du transfert de crédit de taxes ;

- Dans la pratique, l'octroi des exonérations se fait, soit dans le cadre des déclarations périodiques, soit sur demande des contribuables ; les autorités habilitées à donner ces exonérations sont le Ministre chargé de la réglementation fiscale et, par délégation de pouvoirs , les chefs de département des Administrations fiscale ou douanière.
Cet octroi est souvent perçu comme un moyen d'echapper à l'impôt et comme un enjeu de "transaction" entre l'administration et l'administré.

La pratique des exonérations douanières, pour laquelle on dispose des données statistiques détaillées pour les années 1995 à 1997, permet, ici, de poser la question de la conformité de la pratique des exonérations avec les objectifs sociaux.

Tableau 2 : Manques à gagner du fait de l'application des régimes d'exonérations douanières(1995-1997)

	en millions de FMG		
	1995	1996	1997 (6 mois)
Dons et aide	82497	15384	16662
Franchise totale	13240	8689	27937
Assistance technique	22421	18748	12831
Code des itvestissements	81383	87807	21064
Franchise partielle	138926	67159	10856
Etat bleu	961	539	84
Total	339428	198326	89434
PIB(milliards FMG)	13639.9	16244.3	
Recettes fiscales(milliards FMG)	1120	1374.2	
Total en % du PIB	2.48	1.22	
Total en % des Recettes fiscales	30.3	14.43	

Source : Direction des douanes

Il ressort du Tableau 2 que les "manques à gagner", du fait des exonérations douanières, représentent 30.3% des recettes fiscales et 2.48% du PIB en 1995 ; les pourcentages correspondants sont de 14.43% et 1.22% en 1996.

En 1995 et 1996, les exonérations du fait des "Franchises partielles"(appliquées aux "envois dépourvus de caractère commercial", en fait "discrétionnaires") et du Code des investissements représentaient plus de la moitié du total de ces "manques à gagner" :
Il est, ainsi, permis de douter de la conformité de la pratique des exonérations douanières avec les objectifs sociaux (éducation, santé, lutte contre la pauvreté).

5) La perception des contribuables de l'évasion fiscale, apprehendée à travers les résultats d'une mini-enquête auprès de 230 entreprises d'Antananarivo, est traitée dans la sixième partie du rapport final. La tendance des réponses semble, en fait, refléter les réflexions généralement répétées par l'opinion :

- Les principaux fraudeurs appartiennent à la minorité indo-pakistanaise ;
- Les principaux facteurs de fraude sont : la carence de l'Administration, la corruption, et les taux élevés des impôts ;
- Les taux d'évasion les plus élevés sont dans les activités d'achat-vente ;
- Les impôts qui donnent lieu à plus d'évasion sont l'IBS, en ce qui concerne les impôts intérieurs, et les droits de douane, en ce qui concerne les impôts extérieurs ;
- Les principales pratiques de fraude sont les importations frauduleuses et les ventes sans facture ;
- Cinquante quatre pour cent des enquêtés seulement ont affirmé être au courant des dispositions légales sur les Impôts , puisqu ' ils lisent le Journal officiel, régulièrement ou occasionnellement.

6) L'enquête "population fiscale" a été suivie d'une enquête "administration fiscale". Les Administrations fiscales et douanières étant en pleine phase de restructuration (en vue d' une répartition plus fonctionnelle qu 'administrative des tâches), cette seconde enquête a été réalisée dans de moins bonnes conditions. Les réponses suivantes sont les plus significatives :

a)- Les principaux facteurs d'évasion sont :
- l 'insuffisance d'information et d'éducation sur le plan fiscal
- la mentalité des contribuables
- l ' insuffisance des moyens de l'administration
- la carence des Agents (due à un manque de formation)
- les problèmes de Communication et de présence des services fiscaux (éloignement des bureaux)

b) Le commerce , activité spéculative et secteur de l 'informel, est considéré comme l'activité où l'évasion fiscale est la plus importante.

b)- Sont citées comme pratiques courantes d'évasion fiscale :
- les ventes sans factures ou les sous facturations de vente
- les minorations de revenus ou de chiffres d'affaires déclarés
- l'abus du droit de déduction en matière de TVA

c) - Dans le cadre du contrôle qu 'ils exercent , les agents vérificateurs semblent rencontrer des difficultés de divers ordres , notamment :
- le manque de formation
- l 'utilisation de comptabilité informatisée par les entreprises
- le problème d'application des dispositions du code général des impôts

d) - Les agents interrogés (la majorité) ont répondu que sont en partie fondées :
- les déclarations qui taxent les agents des services fiscaux d'incompétence , d'abus de pouvoir , et de corruption ,
- les affirmations selon lesquelles les services fiscaux ne mettent jamais en cause les vrais fraudeurs et que ce sont toujours les mêmes qui paient l 'Impôt .

7) Les quelques recommandations suivantes, tenant compte des propositions du Comité de surveillance, ont été retenues :

a) - L'amélioration de l'information des contribuables
Cet objectif requiert la mise en place rapide d'une stratégie et d'une structure d'information des contribuables, avec la participation effective des associations professionnelles et d'autres composantes de

la société civile. Ladite structure prendra en charge :

- La diffusion des lois fiscales et de leurs textes d'application ;
- La publication, dans un bulletin officiel, des décisions d'application des lois et des textes fiscaux. Toute décision de principe et d'interprétation non publiée dans ce bulletin officiel ne serait pas opposable au contribuable .

b)- La publication des dérogations et exonérations accordées par l'Administration, y compris la publication des décisions de la "Commission administrative de transaction", créée en 1994.

c)- La publication de la liste nominative des contribuables qui ont commis des infractions caractérisées, dûment constatées par les administrations fiscales et douanières, et des sanctions prises à leur encontre.

d)- L'information régulière des contribuables sur le taux de recouvrement et l'évasion fiscale. En s'inspirant de la méthode utilisée dans la section 2.3 de ce rapport, l'information peut être donnée par type d'impôt et globalement. Dans la structure actuelle du Gouvernement, le service outillé pour cette tâche serait le Sécrétariat Permanent à la Prévision Macroéconomique (SPPM), du Ministère des finances et de l'économie.

Comparative Advantage and Intra-regional Trade for Uganda's Non Traditional Export Comodities: The Case of Uganda, Kenya, Tanzania and Rwanda

Proposal for a Research Study

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January 1998

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1.0 Background

Uganda's export earnings have continued to decline since 1988, while total imports have increased significantly. Trade between Kenya and Uganda has improved although uncoordinated policies appear to have affected the actual level of trade. Meanwhile the sharp widening gap between exports and imports has not only exacerbated the balance of payments problems for Uganda but constrained the country's capacity to service her debts and import essential technological inputs required for the rehabilitation and development of the economy (Table 1a & 1b). While, there was a marked increase in exports from 1994 on-wards, imports also increased by even greater proportion, hence widening the gap. It is thus obvious that with continued decline in export revenues, Uganda needs to diversify her exports, if it is to achieve and sustain high economic growth and minimise her balance of payments problems. The diversification of exports commodities can only be achieved through the introduction of non-traditional exports and increase in the exports of other commodities. The Government has since initiated the rehabilitation of the major exports; coffee, cotton, tea, tobacco and cocoa, but this seemed not to have had a significant impact on the export revenue. Apart from coffee, the major contributors to export earnings now appears to be non-traditional exports (Table 2).

2.0 Macroeconomic Reforms and Trade Policies

In the early 1990s, Uganda initiated significant reform of her macroeconomic and trade policies. The reforms included liberalization of the exchange rate regime, elimination of export taxes along with lowering of import tariffs, and reduction in administrative controls on domestic and external trade in agricultural commodities. One of the most visible results of these changes was a rapid increase in production and export of maize and beans to Uganda's regional neighbours, in particular to Kenya. Export incentives for these crops were further supported by large local purchases within Uganda by the World Food Program (WFP) and other donors. Most of the purchases were directed to regional food aid needs, serving countries such as Rwanda and Burundi and other neighbouring countries facing civil conflict or drought. In the period preceding reforms, exports had been almost nonexistent. But by 1994, non-traditional exports accounted for over 34 percent of the total export earnings, of which beans, maize and sesame, accounted for over 18 per cent (Table 2 and Figures 1 and 2).

Table 1(a): Uganda Balance of Trade (In US $ Million)

	Exports	Imports	Trade Balance
1989	277.7	740.0	-462.3
1990	117.0	617.6	-500.6
1991	173.7	474.8	-301.1
1992	151.2	513.3	-362.1
1993	196.7	597.1	-400.4
1994	417.9	726.6	-308.7
1995	539.8	981.0	-441.2

Source: Key Economic Indicators, November 1994 Quarterly Economic Report Volume 02/94, and Background to the Uganda Budget 1995/96.

Table 1(b) Value of Exports and Imports from Kenya to Uganda (US$ `000')

Year	1989	1990	1991	1992	1993	1994	1995	1996
Exports	354.3	438.0	884.0	1,193.4	1,611.1	1,917.1	2,281.4	2,715.0
Imports	21,973.0	21,347.7	35,750.0	34,577.5	48,408.5	46,956.2	65,738.7	63,766.5

Source: USAID, 1996. Unrecorded Crossborder Trade between Kenya and Uganda: Implications for Food Security (Project CA No. 623-0478-A003180).

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Table 2 **Value of Some Uganda's Agricultural Export Products and Percentage Contribution 1990-93**

Commodity	1990		1991		1992		1993	
	$US 000	%age of Total Exports	$US 000	%age of Total Exports	$US 000	%age of Total Exports	US 000	%age of Total Exports
Coffee	140,384	79.02	120,794	65.38	95,372	64.50	106,741	55.04
Cotton	5,795	3.26	11,731	6.35	8,218	5.56	2,287	1.18
Tea	3,566	2.01	6,780	3.67	7,721	5.22	11,141	5.74
Tobacco	2,941	1.66	4,533	2.45	4,204	2.84	7,011	3.61
Bananas	519	0.29	162	0.09	208	0.14	-	0.00
Beans	4,150	2.34	4,274	2.31	2,782	1.88	12,466	6.43
Maize	3,318	1.87	4,188	2.27	3,894	2.63	19,877	10.25
Sesame Seeds	5,234	2.95	10,517	5.69	6,478	4.38	2,751	1.42
Cocoa Beans	504	0.28	374	0.20	281	0.19	714	0.37
Fruits	-	-	-	-	-	-	528	0.27
Total Non-Traditional Export	24,972	14.06	43,578	23.59	32,342	21.87	66,763	34.42
Total Agricultural Export Crops	152,686	85.94	141,185	76.41	115,515	78.13	127,180	65.58

Source: Background to the Budget 1993/1994 and 1994/1995

3 Problems/Challenges

While, increase in maize and beans trade has been welcome, it has also brought with it new problems and challenges. Discussions with Ugandan policy makers, local trading enterprises, and aid donors indicate that a marketing study focused on maize and beans exports to Uganda's regional neighbours would fill an important gap and prove useful in addressing a number of current pressing policy issues. The three trading partners considered to be of highest priority are Kenya, Rwanda and Tanzania. Exports could also occur to Republic of Congo (Zaire) and Sudan and could possibly occur to Southern Africa in some years later, but logistical difficulties and limited resources make research on trade with those locations difficult. Therefore this research will limit its focus to exports to Kenya, Rwanda and Tanzania.

The first issue given high priority by decision makers is the volatility of regional maize and beans demand. A symptom of this problem is the dramatic fall in exports that occurred from 1994 to 1995. Research will assess the sources and magnitude of instability in export to trade over the medium term, and the extent to which policy can assist the stabilization of trade, either through positive measures or the avoidance of destabilizing actions. Such policies would benefit not only Ugandans but also to its neighbours, all of whom have an interest in establishing stable sources of grain supply. This focus on regional food security is consistent with the objectives of USAID's Greater Horn of Africa Initiative.

4.0 Objectives:

The long-term objective of this study is to determine policy options for non-traditional export commodities from Uganda to its neighbours. The specific study objectives include:

(i) To examine price volatility and its effects on trade incentives;

(ii) To examine effect of market instability on the profitability of Uganda non-traditional exports;

(iii) To assess market costs associated with non-traditional exports;

(iv) To assess the extent of trade barriers and determine policy directions for low-value export commodities in East Africa.

(v) To review overtime changes in trade direction due to market competitiveness ~~overtime~~.

2.1 Research Focus

This research will take advantage of the fact that a number of studies sponsored by USAID related to maize and beans marketing and production, covering Uganda, Kenya and East Africa as a whole, have been carried out. These will provide essential background, and substantially reduce certain data collection tasks.

Research will focus on three questions.

- ☺ The first is of a preliminary nature and provides background for the study: What are the long-term prospects for Ugandan maize and beans exports to Kenya, Rwanda and Tanzania?

- ☺ The second assesses the cost of marketing functions from farmer to final buyer: what are the main marketing costs associated with the export trade, what are the opportunities to reduce them, and what would be the effect of their reduction on market price and volumes?

- ☺ The third examines policy distortions and trade disincentives. What effects do government policy interventions through administered prices, export tax, subsidy or exchange rate have on the degree of competitiveness and comparative advantage of tradeables and hence the incentives to produce and export maize and beans to the region?

3.0 Research Methodology

Measurement of comparative advantage is based on the principle of **opportunity cost**. In order to compute the opportunity cost of inputs used, shadow pricing will be used. Determination of shadow pricing involves determining implicit prices of traded items. This process involves determining "border prices". For exports and imports, these will normally be based on f.o.b and c.i.f prices respectively. These are then adjusted to account for domestic and marketing costs between the point of import or export and selling point.

For purpose of analysis, shadow price estimation for tradeable inputs and outputs will be based on the following assumptions;

(i) Tradeable inputs - input cost will be valued at c.i.f prices, including domestic handling, transport and selling costs to estimate import costs (foreign cost),. To account for the foreign exchange component, the official exchange rate will be used.

(ii) Tradeable outputs - output prices will be valued at border prices f.o.b, less transport and marketing costs to the border point to reflect farm gate price.

(iii) Domestic Resources - Non-tradeables are those items whose c.i.f prices are greater than domestic cost of production, hence greater than the f.o.b prices. Non-tradeable prices will be adjusted using appropriate conversion recommended for official use (eg conversion factor for hired labour = 0.90, family labour = 0.60

and other local cost = 0.80).

The methods and data required to study each of the research questions listed above are now discussed.

3.1 Prospects for long-term Trade

The prospects for long-term trade can be evaluated by examining the domestic resource cost (DRC) ratio for non-traditional exports in Uganda and Kenya and other countries respectively. DRC measures cost incurred per unit of foreign exchange earned from export or saved from import substitution. this is expressed as:

$$DRC^{I}_{C} = \frac{(b_{ik}P^{I}_{k})}{P^{I}_{i} - (a_{ij}P^{I}_{j})} \quad (1)$$

where:

DRC_i	=	domestic resource cost of a dollar earned or saved for i^{th} commodity.
b_{ik}	=	quantity of the kth domestic factor needed to produce a unit of output i.
P^{I}_{k}	=	shadow price of domestic factor k.
P^{I}_{i}	=	shadow price of commodity output i.
a_{ij}	=	quantity of $_j^{th}$ tradeable input needed to produce a unit of output i.
P^{I}_{j}	=	shadow price of tradeable input j

Equation (1) can then be used to determine whether a country has a comparative advantage in the production of a given commodity, if the opportunity cost of producing an additional unit of that commodity is less than the border price. Hence, this is given by the ratio between the opportunity cost of a dollar earned or saved through domestic production and trade at a given exchange rate.

3.2 Trade Competitiveness

The second question seeks to examine the degree of competitiveness of maize and beans in terms of financial profitability to producers and exporters. To assess these, both **gross margins (GM)** at the farm level and **net financial benefits (NFB)** to the exporter are estimated.

$$GM = GR - (TPC - FC) \quad (2)$$

where:

GM = Gross Margins per unit

GR = Gross Returns per unit

TPC = Total Production Cost per unit.

FC = Fixed Cost

To determine the financial benefit to the exporter, the net financial benefit is estimated as the difference between the financial value of exports at domestic prices and the cost incurred in producing exports. This is given by the ratio between financial benefit and the cost of production. This is expressed as:

$$NFB_i = \frac{P^d_i(OER)}{X_{ij}P^d_j} \quad (3)$$

where:

NFB_i = net financial benefit ratio.

P^d_i = world price for i^{th} commodity.

OER = official exchange rate

X_{ij} = quantity of jth input needed to produce a unit of output i.

P^d_j = domestic price of jth input.

Equation (3) determines whether it would be profitable to produce a given commodity for trade. If the ratio is greater than one, then it is profitable and vice versa.

3.3 Effective Trade Protection

An effective protection coefficient (EPC) is to be used to assess the effect of government policy interventions on competitiveness and comparative advantage of maize and beans and the incentives to produce and export them. The EPC measures the effect of protection and the resultant distortions in export incentives. This is expressed as the ratio of the value added at given domestic market prices relative to value added at shadow prices.

Hence:

$$\text{EPC} = \frac{\text{value added at domestic prices}}{\text{value added at border price}} \quad (4)$$

From equation (4), if EPC > 1 at the given exchange rate, means that government protection policy measures have positive effects on incentives to producers of maize and beans for export and vice versa. Since, net value added is estimated after deducting from the output value all costs of inputs, including depreciation, it therefore represents the return to factors of production; namely; land, labour and capital.

3.4 Intra-industry Analysis

Given the level of trade within the region especially Kenya and Uganda, it is necessary to identify the major determinants of the intra-industry trade among Kenya, Uganda, Tanzania and Rwanda. An index of intra-industry trade (IIT), based on Grubel and Llyod (1975) trade model is adopted here, The IIT is expressed as:

$$IIT^k_{ij} = \frac{(X^k_{ij} + M^k_{ij}) - |X^k_{ij} - M^k_{ij}|}{X^k_{ij} + M^k_{ij}} * 100$$

$$= [1 - \frac{|X^k_{ij} - M^k_{ij}|}{X^k_{ij} + M^k_{ij}}] * 100 \quad (5)$$

where $IIT_{i,j}$ represents two counties in trade, k is the commodity, X and M are exports and imports respectively. The value of IIT ranges from 0 (where there is no trade) to 100 (when there is full intra-industry trade such that X = M).

3.5. Data

The above investigation requires extensive data for the main price and marketing variables. These include

1. Ugandan farm level prices and other countries farm level prices too.

2. Marketing costs from selected producer locations in Uganda (Kasese and one other location in the west, and Tororo and Mbale in the east) to consumer markets in neighbouring countries. Similar locations in Kenya, Tanzania and Rwanda will have to be established.

3. Prices at the border: with Rwanda, Kenya, Tanzania and at Kampala for regional exports of food aid (these change due to supply and demand factors within those countries, including interventions in Kenya and other countries).

4. Exchange rates and trade barriers operating among the countries.

A number of valuable studies have been carried out by the USAID-supported Export Policy Analysis Unit (Ministry of Finance and Economic Planning) and the USAID REDSO office in Nairobi have documented costs. These will be built on the fully documented range and magnitude of costs borne by marketing agents including those associated with transport, storage, losses in the marketing chain, trading transactions (e.g the costs of compliance with or avoidance of government regulations - see Stryker and Shaw) and risk. Risk factors are considered very important in this study. As part of this investigation it will be necessary to interview different types of marketing agents, characterize their decision making processes and expectations and describe the sources and quality of their information.

An important information requirement for this analysis is good quality price data. The Kenyan Central Bureau of Statistics has a long monthly commodity price series extending from 1980 to the present which is of fair quality. The USAID funded Marketing News Service, located in the Kenyan Ministry of Agriculture, started in the late 1980s, has detailed data of much better quality and fair geographical coverage. The data in both countries is thus adequate for the proposed analysis. The data situation in Rwanda and Tanzania will be determined once a research team leader has been identified.

The final analytical task is to identify realistic opportunities for marketing cost reduction and to simulate the impact of cost reduction on producer and consumer prices, market flows, and border revenues. As mentioned, documentation of marketing costs will include consideration of transactions costs, including those incurred at the border (see Stryker and Saw, and C. Ackello Ogutu), as well as standard items such as storage, handling, and transport.

4.0 Expected Research Outputs and Policy Recommendations

4.1 Research Output

The outputs arising from this research will become available in stages. In the first stage, researchers from each country (Uganda, Tanzania, Rwanda and Kenya) will write a background paper. The first section of the paper will focus on that country's long term comparative advantage in maize and beans production, summarizing commodity DRC ratios and estimates of supply/demand balances for the country. The second will consist of an analysis of the sources and magnitude of price this will extend from farm to border export points, while the neighbouring countries researchers will carry the analysis from the border to their consumer markets.

4.2 Policy Implementations

Recommendations arising from this research may include:

- measures to improve marketing intelligence for the Ugandan government, the private sector, donors, and Uganda's neighbours
- measures to improve the predictability of trade through more consistent implementation of government policies
- proposals for bilateral trade discussion between Uganda and its neighbours
- measures to modify border administration rules or to improve implementation of existing rules
- measures to improve internal trade controls and administration in Uganda identification of investment priorities in the Uganda marketing chain
- proposal for promotion of increased private sector investment in marketing functions, both on and off farm
- measures that may help to improve integration of domestic markets over space and time

4.3 Audience for the Research

The main audience for the research will be Ugandan government and line ministries dealing in trade negotiations and export promotion, the Ministry of Finance and Economic Planning, and the Ministry of Trade and industry, respectively. The Ministry of Agriculture, which has a chief concern over food security, has also expressed interest in the research. Other interested organizations are donor projects such as USAID's Investment in Development of Export Agriculture (IDEA) project and the Export Policy Unit (EPAU) project, as well as private sector entities such as the Uganda Grain Exports Association. The USAID REDSO/ESA office has an interest in the research as it builds on their ongoing work on regional trade. The work is also directly relevant to USAID's Greater Horn of Africa Initiative, which seeks to improve food security in the region.

5.0 Proposed Workplan

It is proposed that the first year of activity begin on or after March 1998 with travel to Kenya, Tanzania and Rwanda by Dr Fred Opio and Dr Marios Obwona to initiate the study and begin the process of field coordination, bilateral trade reconciliation and policy evaluation. Then, in July or August 1998, project participants would travel to Uganda for a seminar to present their background papers and discuss about data collection and associated problems.

Finally, at the end of 1998 the researchers will come together to present and discuss their results at a joint workshop at a venue to be decided. In that workshop, discussants will include both fellow-researchers able to review each study's methods, and other analysts able to review the implications of the work for policy-making.

A rough **time-table for the project is as follows:**

Feb.-April	Research collaborators complete I/O concordance
May-June	Research collaborators complete bilateral trade data & policy measures and attend a seminar in Uganda in July or August.
Sept.-Nov.	Research collaborators complete policy analyses using data & models developed
Jan/Feb 1999	Policy analyses reports presented at EAGER workshop to be disseminated by EPRC & EAGER.

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Ng`eno N.K., 1989. Kenya Export Performance, Praeger Press, New York

7.0 Experience and Qualifications of the Research Team

The Proposed team includes:

1. Fred Opio, Ph.D., Principal Researcher and Uganda Specialist. Fred is the Executive Director of EPRC with over 20 years extensive experience as a researcher and academic in Asia, Pacific, Southern Africa and East Africa. Dr Opio is responsible for the Uganda component and overall coordinator in Eastern Africa. His vast experience and knowledge of these countries is an asset in the study.

2. Dr Marios Obwona is a Senior Research Fellow at EPRC. He is an Econometrican/Modeller with over 10 years of university teaching. Has published widely in refereed international and local journals. Dr Obwona will be responsible for data and empirical analysis.

3. Dr. Willis Oluoch-Kosura. Dr. Oluoch is a senior lecturer in agricultural economics at Nairobi University, Kenya. He has 18 years of experience as a researcher/lecturer and has worked extensively on cross border studies with Prof. Ackello-Ogutu in Kenya. Dr. Oluoch is nominated for the role of senior researcher because of the length of his experience, as well as his mastery of domestic resource cost methods and related policy analysis tools and other trade studies undertaken by him. He will lead the Kenya Team.

4. A staff at the ESRAF in Tanzania - to be identified by Prof. Sam Wangwe.

Detailed C.Vs of research collaborators will be provided later.

OPERATIONAL INFORMATION

Time Schedule

Time	**Tasks:**
1998	
Feb-April	* Review of the work already done in related areas in Kenya and Uganda
May	* Questionnaire design
June	* Recruitment and training of field staff (interviewers and supervisors)
July	* Sample frame construction and sample selection
Aug	* Pilot testing of questionnaire
Sep	* Revision of the questionnaire
Oct/Nov	* Data collection
1999	
Dec-Feb	* Data processing and analysis
March-July	* Report production
Aug	* Dissemination of report findings at EAGER workshop

Competitiveness of Uganda's Manufacturing Sector: The Current State and Prospects.

Paper delivered at the EAGER Workshop, Johannesburg
4-6 February, 1998

By

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First Draft, Not for Quote

1.0 Introduction:

As the next decade ushers the 21st century, competitiveness is going to be one of the key determinants of individual enterprises success within nations, and overall trade and growth performance of countries.

In an environment of very low or zero barriers to trade, only the most competitive enterprises will be able to export and gain international market share. Even enterprises oriented towards the home market will have to compete against imports in order to retain their share.

By available macro-economic indicators, the Ugandan economy has performed well over the past 10 years 1987/1996 under the stabilization and structural adjustment policies. Real GDP recovered from the decline of the 1970s and early 1980s to a positive growth 6.5.% p.a. Inflation was slashed from 300% p.a. in 1986 to under 10%. The exchange rate is market-based, having reduced the premium of the parallel over the official market rate from 300% to zero. Foreign reserves have grown to 4 months' worth of imports. Structural change has started, with the share of the manufacturing sector in GDP growing from 3% to 7%.

However, Uganda's ability to compete in the World market is far from assured. The last 10 years have seen unprecedented growth of imports replacing local import-substitutes in textiles, shoes, bicycle tyres and tubes etc. (IFO, study 1997). This has sparked off a debate as to whether the surge in imports is due to poor imports policy which allows untaxed goods, including second-hand items, to penetrate the home market, or due to Uganda government

liberalizing too rapidly and opening its borders to neighbouring countries to displace local producers, without obtaining reciprocal concessions.

Uganda's exports are practically all agricultural, as illustrated in table 1A. Coffee dominates the traditional exports category, with wide swings in foreign exchange earnings, as the international price of coffee rises and falls. The non-traditional exports category is equally dominated by unprocessed agricultural items on which little value is added.

Manufactured exports are minute, less than 2.% of exports receipts. Items like soap, hoes, chicken feed, depend on the civil war misfortunes of the neighbours: Rwanda, Burundi, Sudan, Democratic Republic of Congo. If these neighbours restore their productive capacities under peace, Uganda's competitiveness in their markets is not assured.

Processed and frozen fish have been the fastest growing category among manufactured exports. But during the calender year 1996/97, Uganda's fish exports to her largest EU market were interrupted twice because of her inability to assure international quality standards to her customers, due to lack of cold storage at Entebbe Airport.

The objectives of this paper are three-fold: to identify Uganda's sources of comparative advantage on which she should base her competitiveness at home and in the international markets; to evaluate how successful the policies over the past 10 years have encouraged competitiveness; to identify the sources of the remaining distortions which additional policies should address to improve competitiveness of the manufacturing sector. The distortions will be measured in the individual enterprise case studies.

2.0 Sources of Comparative Advantage of Uganda's Manufacturing Sector:

The bulk of the work on comparative advantage uses Domestic Resource Cost Ratios calculated from the cost of production semi-annual publications by the Agricultural Secretariat of the Bank of Uganda. These studies do not indicate what happens to comparative advantage when processing is allowed.

The Uganda Investment Authority commissioned an exploratory study of competitiveness and comparative advantage in 1994, based on an enquiry into Uganda's Natural

Resources, and Human Skills. The tentative results are summarized in the Republic of Uganda. Indicative Industrial Plan (1995). The study makes the following observations:

1) Uganda should not base her estimation of comparative advantage on unskilled-labour-intensive industrialization in the 21st century during which trade is going to be dominated by highly-skilled-labour intensive goods. Instead, Uganda should intensify her skill acquisition in preparation to compete. Unskilled labour is expensive because of its low productivity. Table 1 provides some illustrative numbers of the paucity of skills in Uganda's 16 manufacturing establishments surveyed in 1995.

Table 1

Distribution of Workers with more than Secondary Education By Employee Category (Per Establishment)

B. Education Levels	None	Vocational/ Technical	Polytechnic	University
1. Management	7	2	6	27
2. Administrative/Clerical	11	10	10	11
3. Commercial/Sales	14	12	9	7
4. Supervisor/Foreman	12	11	16	3
5. Technicians	13	9	19	1
6. Maintenance	26	10	4	2
7. Skilled Production Workers	25	12	3	2
8. Other Production Workers	35	6	1	0
9. Apprentices/Trainees	37	4	1	0
10. Support-staff	39	3	0	0

Source: Sample Survey of Manufacturing Enterprises (1995) Labour Market Questionnaire (P.12)

2) Uganda has comparative advantage in resource intensive industries, based on her resource inducements, such as limestone, clay, kaolin, quality sand, phosphates, and gypsum. These resourses can be used to manufacture items like cement, lime, walls-floors-and-roof-tyres, refractors, seramics, glassware and fertilizers.

3) Uganda has comparative advantage in agro-based industries. But the selection should emphasize those products in which she can add maximum value. The sugar industry was analysed in detail because of the prospects to make a wide range of products: refined sugar, confectionaries, molasses to make ethnol for blending with gasoline, bagasse to make biogas etc.

Other possible agro-based industries indentified include: manufacture of fish products, grain-mill products, wood and wood products; garments (from cotton); and packaging matrials.

As far as possible, this study will follow the comparative advantage suggested by the UIA study (1994), in the selection of case studies for the analysis of competitiveness. These are the industries with the best prospects for growth.

An attempt will also be made to compare the Ugandan case studies with those of Kenya, especially in cost-structure.

The four cases so far chosen are: chicken feed-meal (using local raw materials), soap, Dairy products and shoe-making.

3.0 The Policies Pursued to Remove Market Distortions:

It is a fair judgement to stress that Uganda has no industrialization policy that protects infant industries, as such.

Uganda's orientation has been to liberalize markets: that of foreign exchange by making the exchange rate market-based; the deregulation of a wide range of prices: petroleum prices, producer prices of export crops, interest rates, prices of manufactured goods by parastatals, etc.

The third area of liberalization consisted of dismantling Cotton, Coffee, and the Produce Marketing Boards. Move recently, since 1993, privatization is disengaging the state from a wide range of parastatals.

The liberalization of the foreign exchange market also entailed the dismantling of foreign exchange controls and allocation procedures.

It is important to take note of what has been accomplished by the general thrust of trade liberalization policies: this has removed a very wide range of price distortions which are the concern of the analysts of competitiveness and comparative advantage.

3.2 The Tariff Regime and Distortions of Resources Allocation To Industry

Uganda's tariff regime has several distortions which affect the competitiveness of industry. The focus of the tariff regime is on revenue collection rather than industrial protection, however.

As laid out in table 2, Uganda had to make a dramatic revision of her tax structure. The tax system remains highly regressive, relying on trade taxes, throughout the 1980s and the 1990s.

When the economy deteriorated through mismanagement in the 1970s, the capacity for tax administration was eroded. By the early 1980s the major source of recurrent revenue was coffee, which contributed close to 40% of total recurrent revenue in 1986/87. Unfortunately by 1991/92 the international price of coffee had fallen so low that to levy the coffee tax would have practically wiped out coffee exports. The country had to find another tax base.

Petroleum products constitute the largest single source of tax revenue, contributing 23 - 26% of total reccurent revenue.. In terms of competitiveness, this raises transport costs for the entire economy, relative to the neighbours and contributes to smuggling of Kenyan goods into Uganda. The final result is mixed: revenue from petroleum products is not maximized because petroleum products are over-taxed and smuggled into Uganda. Other effects include disintegration of the economy as upcountry farmers bear a larger proportion of the petroleum products tax; this narrows the Ugandan internal market for import-substitution!

Table 2

Evolution of The Tax Structure

(Percentage Contribution to Total Resources Revenue)

	1981/82	1986/87	1990/91	1994/95	1995/96	1996/97
1. Income Tax	9.3	11.4	10.2	14.5	12.8	13.0
2. Indirect Taxes of which:	90.7	88.6	89.8	83.8	86.0	85.0
a) Export Taxes	27.7	39.9	9.4	2.7	2.0	0.4
b) Customs Duty of which:	21.2	11.9	36.5	35.9	36.7	38.4
c) Sales Tax/VAT (imports)	...	...	26.6	22.5	23.3	26.1
d) Excise duty	7.5	6.8	9.1	0.8	10.5	13.3
e) Sales Tax/VAT (Local)	30.7	25.3	26.9	25.7	27.6	27.9
3. Non-Tax Revenue	0.0	1.0	1.9	1.7	1.2	2.0
Total Tax	100.0	100.0	100.0	100.0	100.0	100.0

Source: Republic of Uganda, Background to the Budget (various Issues). Kampala: Ministry of Planning and Economic Development.

Other trade taxes fall on beer, cigarettes, soft drinks, etc. These taxes unintentionally protect the industries by raising the local prices relative to imports.

In general, however, the debate is on what the state accomplishes by the taxes. Protection of industry is not guaranteed because of smuggling, and frequent changes of trade taxes to maximize revenue, which discourages investment.

The maximization of revenue is not guaranteed either. Traders of the taxed commodities misclassify imports under tariff codes with lower tariff rates, or outright smuggle in imports.

One of the first tasks of this research is to calculate the weighted average actual tariff rates levied by the state on imports and compare this with the nominal tariff rates put in the Finance Bills each year, intended to maximize revenue. Until this is done, it is unclear whether the tariff regime distorts resource allocation to industry.

There are no subsidies to exporters. There is a refund of the Value Added Tax (VAT) on imported inputs to manufacture exports. It is not clear whether local inputs into exports manufacture are tax refunded. If local inputs pay tax, this is indirect and biases the manufacture of exports towards import-intensive processes.

Table 3 suggests that on the balance, the tariffs and exchange rates impart a small anti-export biases. The exchange rate, although unified, was appreciated during the coffee boom, and imparted a small anti-export bias from 1993. These data will be analysed further and used to measure the distortions in the incentive structure facing manufacturers.

Table 3
The Incentives Structure for Exports

Year	Real Effective Exchange Rate	Parallel Market Premium $\frac{(EP - EO)}{EP} \cdot 100$	Effective Import Tariff Rate = tm	Effective Export-tax Rate=tx	Anti-Export Bias. (1+tm)/(1-tx)
	(1)	(2)	(3)	(4)	(5)
1980	898.77	850	0.00	0.0	1.00
1981	654.33	918	0.03	0.01	1.04
1982	227.09	183	0.13	0.21	1.43
1983	178.49	106	0.10	0.28	1.53
1984	120.55	55	0.08	0.29	1.52
1985	157.38	366	0.08	0.37	1.72
1986	165.91	306	0.03	0.33	1.54
1987	212.73	200	0.05	0.16	1.20
1988	192.59	118	0.07	0.18	1.26
1989	163.64	67	0.08	0.09	1.15
1990	100.00	27	0.13	0.18	1.33
1991	76.61	21	0.19	0.10	1.26
1992	70.41	8	0.17	0.01	1.15
1993	75.68	0	0.23	0.00	1.17
1994	94.14	0	0.23	0.00	1.17
1995	91.56	0	0.24	0.03	1.20
1996	91.24		0.25	0.02	1.21

Source: Research Department, bank of Uganda. 1997.

REER = Real Effective Exchange Rate (an increase in value represents appreciation and anti-export bias).

Parallel Market Premium $= \frac{(Ep - Eo)}{Ep} \cdot 100$

Effective Import-Tariff Rate tm $= \left(\frac{\text{total value of tariff revenue}}{\text{total value of Imports}}\right) \times 100$

Effective Export Tax Rate tx $= \left(\frac{\text{total value of export tax}}{\text{total value of exports}}\right) \times 100$

Anti-export Bias $= (1 + tm)/(1 - tx)$

E = nominal exchange rate; 0 = official, P = parallel market

tx = effective export tax rate

tm = effective import tariff Rate

3.3 The Investment Code

As with the tariff structure, Uganda's Investment Code 1991 is not streamlined to encourage industrial investment - it is general, designed to encourage all investments. The key incentives are:

1. Import duty exemptions on plant, machinery and construction.

2. Import duty exemptions on industrial inputs.

3. Corporate Tax holiday.

The pieces of evidence in Table 4 show the response of investors to the Investment Code. It is clear from each block of evidence that the Investment Code has neither encouraged exports (Block 1) nor was it exclusively slated to encourage manufacturing (blocks II and III).

For the purpose of this paper, the key question is whether the Investment code is encouraging competitiveness. The specific case studies of manufacturing establishments have provisional questions to estimate the extent to which the exemptions distort the incentive structure facing investors.

The current debate over reforming the Investment code have concentrated upon:

a) The code favouring foreign and large-scale over local investment, despite the fact that the majority of investors since 1991 are local

b) The code forces government to forego tax revenue, while a low uniform tax rate would not discourage investment. What matters is the **predictability** of the tax rates for investment planning.

These questions will also be examined.

The Investment Code has no provision for encouraging adoption of new technologies, the training of human resources, research and development. These are some of the factors that would enhance Uganda's competitiveness and comparative advantage. An assessment of their inclusion in the revised code, or a new code altogether focused on competitiveness, will be done.

Table 4

I. Marketing Orientation of Newly Approved Investment Projects (1991/93)

	number	% of Total
Export-oriented	30	9
Import-substitution	171	51
Non-tradable	135	40
	336	100%

Source: Maxwell stamp/LPC: Study of the Effectiveness of Policies, Facilities, and Incentives for Investment promotion, Uganda Investment Authority 1993,

II. Break-down of Tax Exemptions by Sector from a sample of 32 establishments(%).

Sector	1991	1992	1993	1994	1995	Overall
Services	0	27	15	28	22	22
Trade	0	16	57	47	35	41
Manufacturing	100	57	28	25	43	87
Total	100	100	100	100	100	100

Source: D.L. Kibikyo (1997). The Impact of Tax Incentives on Tax Revenue and Foreign Direct Investment in Uganda: 1991-1995. MA Dissertation submitted to Makerere University. The Department of Economics.

III. Sectoral composition of Registered Projects 1996.

Sector	Percentage of total number of licenced projects
Manufacturing	27.22
Agriculture	24.59
Trade & Restaurants	8.97
Construction	9.89
Insurance and Business Sercices	9.23
Trourism	8.53
Personal and social services	2.69
Mining and quarrying	1.63

Source: Republic of Uganda, The Parliament of Uganda (1997), Report of the Sessional committee on Trade, Industry and Information on the 1997/98 Budget.

3.4 Market Failures:

The attention in Uganda has been on liberalizing, particularly decontrol, of key prices and marketing institutions. The assumption has been that once government control is removed, the key markets would function competitively to allocate resources efficiently. However, some glaring market failures are evident.

The financial sector, despite reforms since 1993, is not functioning properly. Interest rates are 20 - 25% on commercial loans of up to one year maturity. Such loans are for commerce; however, for competitiveness, industrialists need to borrow to purchase new plant and equipment, to overhaul obsolete production processes that are subject to frequent break-downs and lack of spare parts. Capacity utilization, on the average, is around 3 % in Uganda.

Commercial banks demand collateral out of which only 2/3rds of actual loan value is obtained. Compared to offshore financing of coffee marketing at a 7% interest p.a. and backed by coffee itself, as collateral, Uganda's financial market appears uncompetitive, inefficiently collecting expensive loans on a few paying customers while piling up non-performing assets.

On infrastructure, Uganda's performance is equally poor. The Uganda Electricity is intermittent, with blackouts estimated at 13 of the 30 days in a month. The collection of charges is arbitrary and irregular. In Arua district, electricity comes on at 7.00 p.m. and goes off at 11.00 p.m. The extra cost entrepreneurs incur by running diesel power generators is a distortion due to market failure that must be estimated, since it reduces competitiveness.

The National Water and Sewerage Corporation is trying to restore water services, but these are still limited. In Arua district, for example, as of July 1997, there was <u>no</u> running water for domestic consumption or industry.

Telecommunications is another piece of infrastructure whose supply is quite poor. Connections to towns outside Kampala require queuing up in Arua, for example, up to 5 minutes for Entebbe, and non-existent for Mbale.

Roads are extremely rough and have been made much worse by the recent floods of October/January 1997/98 even in Kansanga (a wealthy suburb of Kampala, the capital city).

The main point is that the multiplicity of market failures raise the cost of doing business in Uganda and reduce competitiveness. It is not surprising that despite the

large sums of money spent on campaigns, Direct Foreign Investment (DFI), is extremely thin and recent. It is recorded in the balance of payments statistics only in 1995 and 1996, at 1.5 m. US $ p.a.

The importance of market failure, and concrete suggestions on what to do about it, are [illegible] parts of the analysis of competitiveness. They are included in the questionnaire to the manufacturing enterprises.

4.0 Procedures to collect Data on Enterprises

Our proposal was to collect data on specific enterprises to use to compute unit costs as indicators of competitiveness. From what I have experienced in Uganda, the following are perttinent:

1. The specific enterprises should be those with potential comparative advantage, as suggested in Section 2.0 of this paper. As far as possible, as many of these enterprises should be comparable to those of Kenya, to unify the study themes. But this may not work in every case.

2. The Audited Accounts, per establishment, [illegible] the basic data. The accounts then are desegregated, and balanced, with the profit before taxes as the residual balancing item of Total Revenue <u>less</u> total [illegible]xpenditure. This can be done in the first round of visits to the enterprise, and some homework, within a total time of 3-5 hours per enterprise. (Three examples completed are attached to this report).

3. A <u>return</u> to the enterprise, <u>plus</u> homework, up to 5 hours per enterprise, is necessary:

   a) to sort out whatever did not balance under No.2

   b) to discuss distortions, as outlined in section 3.0 of this paper.

   c) to desegregate observed market values and distinguish them from efficiency values (without distortions).

4. The computation of unit cost: 3 - 5 hours per enterprise.

5. Comparison with Kenya, and write-up of each case study 5-10 hours.

At this rate, the first draft will take 30 working weeks or 9 months, if one did 30 firms.

Comments are highly appreciated, to improve the work.

Table 1 A

Composition of Exports

Value (US dollar million)

Export type	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
1. *Traditional Exports*	*343.60*	*244.10*	*344.10*	*353.40*	*376.10*	*371.90*	*405.60*	*317.20*	*269.20*	*272.20*	*151.65*	*140.90*	*111.22*	*126.58*	*376.82*	*440.08*	*419.08*
Coffee	338.70	241.60	340.00	339.70	359.00	355.00	397.30	311.20	264.30	263.60	139.31	117.85	95.19	106.77	356.90	419.01	396.10
Cotton	4.30	2.20	3.30	11.60	12.40	15.40	5.10	4.10	3.10	4.00	5.72	11.73	7.25	4.29	2.49	3.56	7.55
Tea	0.30	0.30	0.80	1.20	3.20	1.00	3.20	1.90	1.20	3.10	3.68	6.78	4.66	8.10	10.47	8.02	10.58
Tobacco	0.30	0.00	0.00	0.90	1.50	0.50	0.00	0.00	0.60	1.50	2.94	4.53	4.12	7.41	6.96	9.50	4.86
2. *Non-traditional exports*	*2.20*	*2.50*	*1.30*	*13.40*	*16.70*	*7.40*	*5.80*	*3.10*	*3.20*	*4.10*	*21.55*	*38.52*	*28.58*	*55.27*	*82.07*	*108.39*	*208.95*
a) Grains	0.00	0.00	0.60	11.30	10.10	3.10	1.10	0.00	0.30	0.00	13.21	18.05	15.08	30.90	34.23	21.70	30.58
Cereals 2/	0.00	0.00	0.60	11.30	10.10	3.10	1.10	0.00	0.30	0.00	3.32	4.34	4.03	15.34	21.90	8.44	13.20
Beans											4.15	4.39	3.07	12.37	10.70	6.14	6.41
Simsim											5.23	9.32	7.99	3.19	1.27	6.44	9.76
Cocoa Beans											0.50	0.00	0.00	0.00	0.37	0.68	1.21
b) Processed/semi-manufactured	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.71	4.84	6.22	9.02	20.70	32.06	57.30
Fish & its Products											1.39	3.90	4.63	7.87	14.44	24.25	45.94
Soap												0.00	0.00	0.00	1.86	3.00	2.01
Electricity											1.22	0.94	1.54	1.15	2.37	2.41	4.08
Petroleum Products												0.00	0.00	0.00	0.00	0.37	5.18
Leather												0.00	0.04	0.00	0.00	0.00	0.00
Hoes											0.11	0.00	0.00	0.00	1.66	1.72	0.01
Cotton Seed Cake												0.00	0.00	0.00	0.06	0.00	0.00
Cigarettes												0.00	0.00	0.00	0.32	0.31	0.08
c) Horticulture & Flouriculture	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.66	0.94	0.34	1.00	5.02	3.16	7.84
Fruits & Vegetables											0.42	0.32	0.29	0.25	0.44	0.39	1.14
Flowers												0.00	0.00	0.00	0.88	1.58	3.38
Chillies												0.00	0.00	0.00	0.02	0.00	0.00
Vanilla												0.00	0.00	0.00	1.58	0.01	1.49
Other Pulses											0.24	0.62	0.06	0.75	2.11	1.19	1.83
d) Raw Materials/Semi-Processed	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	4.22	2.60	3.45	5.77	9.89	9.06	8.44
Hides & Skins											4.07	2.38	3.38	5.75	9.86	9.06	8.44
Goats & Sheep												0.00	0.00	0.00	0.03	0.00	0.00
Timber											0.14	0.22	0.07	0.02	0.00	0.00	0.00
e) Gold												8.48	0.00	0.00	0.00	0.00	41.89
Other Minerals												1.93	0.54	1.27	1.88	26.07	25.81
f. Other exports	2.20	2.50	0.70	2.10	6.60	4.30	4.70	3.10	2.90	4.10	0.75	1.69	2.95	7.32	10.34	16.34	37.10
Total	345.80	246.60	345.40	366.80	392.80	379.30	411.40	320.30	272.40	276.30	173.20	179.41	139.80	181.85	458.89	548.48	628.03

Source: Research Department, Bank of Uganda 1997.

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Contracting in Tanzania

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January 1998

This paper presents the findings of research conducted jointly by the IRIS Center, University of Maryland, and the Economic and Social Research Foundation of Tanzania, under the USAID-funded EAGER Project. IRIS and ESRF gratefully acknowledge the USAID financial support. The IRIS team also wants to thank Kerry Hoke for her research assistance.

I. INTRODUCTION

Low-cost and impartial contract enforcement procedures are commonly held to provide a critical incentive for trade and exchange and, thereby, facilitate economic growth. These procedures enhance predictability in the system by restraining opportunism among contracting parties. This reduction in uncertainty decreases the cost of exchange and promotes transactions.

The objective of this paper is to reconstruct the behavior of Tanzanian industrial firms in the purchase and sale of supplies, and the relationship of this behavior to the legal and policy environment of Tanzania. This is done through a survey of Tanzanian manufacturing firms and a review of relevant legal and policy documents.

It will be shown that Tanzanian laws and legal institutions provide very weak support for enforcement of contracts and, thereby, weak support for transactions, specialization, and the use of commercial finance in supply relations between firms. This implies that there is a need for policy measures aimed at improving the contracting and contract enforcement environment.

The outline of the paper is as follows. Chapter two presents an analysis and theoretical discussion. Chapter three reviews the survey results and focuses on the role of Tanzanian commercial legislation and the legal system in shaping the contracting behavior revealed in the survey results. A discussion of policy implications is presented in Chapter four.

II. ANALYZING PATTERNS OF CONTRACTING AND ENFORCEMENT BEHAVIOR

What is the role of efficient coordination and contracting mechanisms in economic performance? These mechanisms allow economic agents to coordinate production and exchange reliably, managing risks, containing transactions costs, minimizing opportunism, and by these means encouraging exchange and specialization, with their attendant economic gains. North (1990) and Williamson (1995) in particular have analyzed economic development in the West and concluded that coordination and contract enforcement mechanisms have played an important role in fostering specialized investments and growth. Williamson points out that the coordination of production and exchange require agreements that are necessarily open-ended. Complete contingent contracting (building all contingencies into an agreement) can be extremely costly even where possible. Efficient coordination therefore requires a legal and enforcement framework that reliably supplies missing terms, channels behavior, restrains opportunism, reduces costs, and enables parties to deepen the complexity and specialization (and therefore the gains) of their relationship. Without such a framework, instead of an optimal spread of spot-market trading, long-term contracting with fixed (asset-specific) investments, and vertical integration, transactions will flee to the poles of spot-markets and vertical integration, abandoning the middle ground of medium and long-term contracting. The gains of specialization and complexity are thereby foregone. (Williamson 1995). These issues are reviewed in more detail in Kahkonen and

Meagher (1997). The role of legal institutions is discussed further below.

II.1 Causes and Effects of Contracting Patterns in Africa

Firms in developing African countries face an unusually high-risk environment, as compared to other regions, and weaknesses in coordination and contract enforcement play a significant role in shaping this environment. Keefer and Knack (1995) present an index of contract enforceability, in which African countries overall score 0.66, as compared to 0.71 for non-African developing countries, and 1.0 for OECD countries. Problems of enforceability combine with other difficulties, such as the vagaries of weather, poor infrastructure, instability in the macroeconomic environment, and restrictive regulatory regimes to create severe risk of non-adherence to contract terms and business failure for African firms. Economic shocks are comparatively frequent in African countries, and firms are generally uninsured and investments illiquid. As a result, firms high risks that they are ill-equipped to handle smoothly. African firms, generally small, uninsured, and undiversified, are often rendered physically or financially incapable of carrying out contractual duties by economic shocks, infrastructural weaknesses and other problems. Lateness or failure to pay or deliver are passed from one firm to the next: "poor performance tends to ripple through the system, traveling upstream and downstream along business networks" (Fafchamps 1996). These problems force African firms to adopt investment and coping strategies that tend to minimize specialization, spread risks, and therefore limit the potential economic gains of production and exchange (Collier and Gunning 1997).

What are these strategies? Collier and Gunning (1997), Biggs et al. (1996), and Fafchamps (1996) provide useful descriptions and analyses of them.[1] Firms are generally faced with the task of accommodating market, price, and supply uncertainties without functioning markets for either insurance or resale of capital stock. Illiquidity results from a combination of the small size of most African internal markets, and regulatory restrictions that have kept markets largely closed to outside competition and fostered oligopoly. As a result, the resale market for industrial equipment and for going concerns is quite weak, and what sales are made tend to be at a steep discount. In other words, investment in plant and equipment by African firms tends to be irreversible. Naturally, firms respond to these risks by reducing or minimizing fixed investments whenever possible. Infrastructural problems such as frequent power failures puts countervailing pressure on firms to invest in extra equipment such as generators.

Transport problems and the weaknesses of partner firms mean that supplies tend to be unreliable. To deal with this risk, firms often hold large inventories and enter into "state-contingent" agreements in which delays and failures are flexibly accommodated. In Kenya, for example, delaying payments is the most common way of dealing with liquidity shocks –

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[1]Collier and Gunning rely on the survey data set developed by the World Bank's Regional Program on Enterprise Development, which samples 200 manufacturing firms each in 8 African countries over the period 1992-1996.

repayment periods for trade credit (typically 30 to 60 days) are frequently renegotiated. Biggs et al. (1996) found that more than half of all trade credits were extended in Kenya during the period of their study. In Ghana, an estimated 90 percent of defaulters are forgiven. These problems are implicitly acknowledged up front in many cases by the use of incomplete contracts where no payment date is specified. A study in Zimbabwe showed that continuation of the business relation is a high priority, and problems of timely delivery and payment appear to increase with the length of the business relationship (Collier and Gunning 1997)

Another major coping strategy is for a firm to confine its dealings to those firms that are known quantities. The limits of social capital in most African countries mean that this strategy can place severe limits on many firms' prospects. In dealing with potential and actual partners, firms need substantial information. In the absence of credit reporting agencies and other specialized information providers, which are generally unavailable in developing African countries, firms must obtain information on their own. This creates pressure to keep one's business network small in order to make possible direct observation, and with it the ability to discern defaults and to distinguish opportunistic ones from those that are unavoidable.

There are two main problems with the strategy of limiting contacts to a tight network. First, the size of such a network is likely to be smaller and more homogeneous than optimal for purposes of learning about new techniques and market opportunities. Learning through such networks has important effects on economic returns (Barr 1996). This is especially critical in developing export markets, which is harmed by the inability to develop relationships with foreign firms--and this in turn is limited by the opaque types of relationships and enforcement strategies that crop up where formal enforcement mechanisms and laws are weak.

Second, such tight-knit networks tend to be based on ethnicity, which would severely constrain the size of any potential network available to most firms in a countries such as Tanzania.[2] Biggs et al. (1996) found that Asian-owned firms had much greater access to trade credit (on a par with large firms having access to commercial bank lending) than African-owned firms in Kenya. The Asian-Kenyan social network was comparatively quite large and included many urban-based manufacturing firms. African-Kenyan networks were quite small, reached extensively into rural areas, but had only a limited urban base, with the result that these networks contained few firms in the modern sector. As a result, African-owned firms had to reach across established networks, and in doing so exercise strict screening and supervision of trade debtors--to the extent of directly observing the premises. Asian-owned firms, by contrast, could "ask around" within their network about the performance of potential and actual trade debtors (Biggs et al. 1996, Collier and Gunning 1997). The impact of substituting policing through social networks for strong formal enforcement mechanisms therefore appears to have direct detrimental effects on productivity growth, trade networks, finance, and indeed entry.

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[2]An interesting example of kinship as a basis for coordination is provided by Orma herdsmen in Northern Kenya, who have found the adoption of herders into their families a more effective means of aligning incentives than contractual employment. Ensminger (1997).

II.2 Economic Stakes for Tanzania

Given the economic situation of Tanzania, what importance should be assigned to the development of effective coordination and contracting mechanisms? Evidence abounds that this is among the most important issues for the development of the economy into the 21st century. This is essentially a result of the private sector's weaknesses, in turn due to its recent and incomplete emergence from socialism over the last decade or so, and an improving but still deeply flawed legal and policy environment.

The transformation of Tanzania's economy has been substantial, but much remains to be done. Currently, the Tanzanian economy consists of three main sectors: the subsistence sector (agriculture, fishing and livestock keeping), based in rural areas, industry, based in urban areas, and the service sector. Agriculture is the biggest sector, producing 50 percent of the GDP from 1992-1994, and producing over 60 percent of the country's export earnings. The industrial sector accounts for 11 percent of the GDP, while the remaining 39 percent comes from the services sector.

Economic reforms in Tanzania started in 1981 with the National Economic Survival Program, the first of four economic programs that lasted until 1992 and constituted the economic reform plan. These programs were followed by the three year rolling plan and forward budget. In the 1990s much progress was made in the transition of the Tanzanian financial system toward a market-oriented system. Although interest rates were liberalized and several private banks were licensed in the mid 1990s, enhancing competition, the system didn't channel enough credit to the productive sectors, such as small and medium sized enterprises, and rural agricultures, instead doing business in the low risk markets. Between 1985 and 1993, inflation in Tanzania dropped from 30% to 24%. In 1994, however, inflation increased to 35.5 percent as a result of deceleration of the growth of the economy and budgetary over expenditures, leading to government borrowing from banks. Starting in April 1996, inflation was on a downward trend and the target of an inflation rate of 15% for 1996/97 looked achievable.

Tanzania has made a commitment, clear in principle but not fully realized in practice, to the development of a private sector as the engine of growth. A necessary part of this vision is the transformation of the public sector from an inefficient producer and intrusive coordinator of production, to a more limited, facilitative, and honest role as provider of market rules and public goods. Through the Parastatal Reform Commission and the Loans Advances and Realization Trust, Tanzania has restructured state-owned enterprises through commercialization, divestiture, or liquidation. By mid-1996, some 123 parastatals had been divested. However, the private sector has not responded to the extent anticipated. There are a number of reasons for this. One would likely be the culture of entrepreneurship that developed under socialism, with private actors essentially exploiting gaps, connections, and black markets, but living within a closed and inefficient domestic sphere (Wangwe 1995). The industrial sector has suffered especially, having to cope with a newly liberalized environment while still burdened with outmoded and inefficient

production techniques. Whole sectors, such as textiles, have become largely defunct. It is also the old industrial enterprises that benefitted most from political and bureaucratic connections in the past, and would have an interest in maintaining them along with a protective policy environment, to the detriment of newer internationally-oriented firms.

In addition, while the amount of financing being extended to the public sector has shrunk with privatization, credit has not been widely available to private firms on commercially feasible terms, and has largely been limited to trading rather than productive activities. There is some evidence of crowding out, as banks forgo private sector lending risks in favor of government bonds (Lofchie 1995). Furthermore, the use of checks has lost favor since the 1980s with most enterprises, which now deal in cash as a result of a non-functioning clearance system (Coopers & Lybrand 1992). Private investment is making up some of the shortfalls, as it has shifted from a public to private sector focus with continued high rates (34.6 during the period 1986-1992, according to the World Bank). However, the structure of investment, as with credit, has shifted strongly in the direction of quick-yielding trade activities, which suggests a continued perception of uncertainty on the part of private investors (Wangwe 1996).

In light of the current status of public sector reform, it is hardly surprising that investors experience uncertainty. The "Investor Roadmap" study conducted in 1996 found, for example, that the process of commencing business operations in Tanzania required some 28 major steps resulting in an average delay of 18 to 36 months, as compared to 6 to 12 months in Namibia and 12 to 24 months in Ghana and Uganda (Rauth et al. 1996). Overly rigid legal, regulatory, and especially tax instruments help explain a large informal sector, estimated to account for between 30 and more than 60 percent of official GDP (ESRF 1996) The Warioba Commission found rampant public sector corruption in its investigations of 1995-6, as did the EDI survey of corruption in lands, revenue, and judicial departments. (EDI 1997). At the same time, signals sent by the Commission and by President Mkapa, for example his post-election declaration of assets in late 1995, demonstrate some genuine commitment at high levels to improve public sector integrity. As is often the case with this type of transition, liberalization and high-level interest in continued policy change have not yet trickled down in the form of thorough institutional reform, nor of ideological shifts by public officials and other non-entrepreneurs.

Entrepreneurs themselves have also shown a lack of capacity. A large dimension of this is simply want of experience, especially among business people of African origin. Attitudes also remain an obstacle. The priority placed by Tanzanian elites on public service, with its accompanying wariness of private enterprise, continues. Furthermore, the risk-management strategies discussed above also apply in Tanzania, and are part of a larger phenomenon of social solidarity and social insurance, in which duties and debts are deferred, and benefits spread, within the kin and social network. This appears to place limits on the size and capital accumulation of some businesses, which hide account information from both public officials and private associates, and in some cases attempt to remain under a certain size or at least keep a low profile in order to avoid public and private demands. Attitudes toward Asian businesses also continue to present obstacles. The connection between nationalization and the push for indigenous African economic

advancement has not been forgotten, and suspicions about the speculative or manipulative intentions of Asian entrepreneurs continue, although this has waned somewhat over the years. Finally, local chambers of commerce such as CTI and TCCIA, while they are on the upswing, do not appear to perform three critically important functions competently, if at all: (i) screening and providing information on performance and creditworthiness of partner firms,[3] (ii) networking with outside investors, and (iii) influencing relevant legislation and regulation. (Coopers & Lybrand 1992, Lofchie 1995).

In view of the above, improvements in coordination and contracting among all firms may be critically needed as part of Tanzania's continuing economic transformation. What is the role of law and the legal system in this problem?

II.3 The Role of Legal Institutions

How do legal institutions foster efficient coordination and contracting? They do so by providing for (i) clear criteria for enforceable agreements; (ii) effective means of adjudicating and resolving disputes; (iii) the functioning of information networks that facilitate screening of potential partners, and policing of debtors and obligors; and (iv) a reasonably stable and honest policy environment that protects transactions against predation and erosion of value. These mechanisms can act either directly, e.g. by enabling parties to take disputes to court or to arbitral bodies; or indirectly, e.g. by signaling the likelihood that state-provided rules and adjudication systems would yield a particular result within a reasonable time, thus setting clear terms for party behavior, for bilateral negotiations between the parties where problems arise, or for dispute-resolution by informal means. (See Kahkonen and Meagher 1997).

II.3.1 Formal Institutions

At the core of the legal system is the judiciary, which becomes increasingly important in handling disputes when transactions are no longer vertically integrated within a command economy. In a World Bank (1997) survey of 3600 businesses in 69 countries, respondents identified an unpredictable judiciary as a major problem in doing business. The action of the judiciary, and of contracting parties, is shaped by substantive and procedural rules, of course, and so the content of these rules can be important. These rules provide default terms, constrain contractual choice, perform evidentiary and cautionary functions, channel disputes into the appropriate enforcement forum, and determine procedures and appeal rights in the court system.

Several analysts have adduced evidence that well-functioning legal systems, and court systems in particular, are correlated with high levels of contract-intensive transactions, i.e. transactions that require relatively complex formal agreements that depend on formal enforcement

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[3]Nor have the company registries provided much help in this regard, since their records have been "so abysmal as to be useless." (Coopers & Lybrand 1992 p. 69)

as the ultimate recourse. These would include the holding of non-cash financial assets, investment in fixed assets such as telecommunications infrastructure, and long-term executory contracts such as loan agreements or other transactions involving the exchange of promises of performance such as payment for production of customized goods (Olson, Keefer and Knack 1995). In sectors with this kind of specific investment, a strong judiciary is especially important for the involvement of the private sector, since the risk of opportunism by contracting parties or the state is especially high in these transactions. The nexus between a functioning judiciary and investment in technology sectors (e.g. telecoms or computer software) appears particularly tight. These investments are highly subject to expropriation or pirating. Lastly, court systems and rules that fail to enforce agreements and restrain opportunism also fail to close off a number of negotiating options even after contracts are concluded, with the result that terms are not respected, agreements are continually renegotiated, and therefore inefficiencies and transactions costs mount (North 1991, Williamson 1995, Levy and Spiller 1994, and Sherwood 1994)

An effective legal system would result in neither too much nor too little litigation. Too much litigation would indicate ineffective barriers to frivolous suits and an over-reliance on courts to sort out problems--a costly method. Too little litigation would evidence a lack of access, legitimacy, or effectiveness on the part of the court system (Pinheiro 1997, Messick 1997) Factors directly affecting the economic contribution of the judiciary include cost, speed, and predictability. Cost and speed are closely related. The value of adjudication would depend on its overall costs, including attorney and court fees (as well as informal payments extracted in some systems), as compared with the present value of the expected gain. The latter can diminish dramatically with delay--e.g. in the case of repossession of goods that lose their value rapidly, or in the case where inflation is high and damage awards are not indexed. Predictability reflects adherence to known rules, and therefore fairness, competence, and avoidance of corruption (Pinheiro 1996).

A more widespread impact of predictability in adjudication would be the signal it sends to potential litigants that commercial rules are stable and reliably enforced, which can have an important impact *ex ante* on coordination between parties. This includes avoidance of opportunism in the form of unjustified breach or lawsuits motivated by frivolous or strategic considerations. While overly stringent procedural and appeal rules can deny justice to some litigants with meritorious cases, overly lax rules fail to weed out those with weak cases or ulterior motives (e.g. corrupt gain or strategic advantage) and to channel the right kinds of disputes into the system (Pinheiro 1996). Some problems with the judiciary are almost unavoidable, especially some dissatisfaction with cost and delay. The quality of justice as dispensed by courts often directly correlates with cost and delay. As a result, arbitration and other alternative dispute resolution (ADR) methods have long been used and are increasingly in demand.

II.1.2 Law and the Spectrum of Coordinating Mechanisms

The courts are part of a spectrum of commercial governance that runs from (i) the overall integrity of public sector political, legal, and administrative functions; to (ii) the judiciary; (iii)

ADR mechanisms; and (iv) information and screening mechanisms. The quality of public sector governance, including the rule of law and the ability effectively to appeal against legal and administrative abuses, shapes the quality of the judiciary, including its independence and integrity, which in turn has a direct impact on cost, speed, and predictability of contract enforcement. Many observers therefore consider public sector governance to be far more important, and more in need of strengthening by governments and international development agencies, than the courts themselves. ADR mechanisms play a necessary role in any society. The social sensitivity, technical complexity, and economic stakes of a dispute will determine at what level it can effectively be resolved: bilateral negotiation, informal mediation, commercial arbitration, adjudication, appeal, administrative recourse, or political advocacy. Less sensitive, more complex, and higher-stakes disputes are likely to escalate.

Information and screening mechanisms--from informal social or business networks to modern filing and credit reporting systems--enable parties to choose partners and courses of action before and during transactions based on information that they consider reliable. As the number of trading partners rises, a firm will be faced with making an increasing number of inquiries about these partners. Where these inquiries are defined by traditional social interactions, the costs of this will rise. These costs will be offset to the extent that the scale of the market permits credit rating and reporting firms, electronic data exchange, and efficient registry systems to be established in a way that reduces these transactions costs. These facilities may be publicly provided or provided by the private sector with an accompanying framework of law that defines their legal effect, protects the integrity of the information provided, and provides rights of redress to those harmed by inaccuracies.[4] Still, an economy, and an individual firm, will reach a point in the growth cycle where it begins to rely more on formal adjudication because its relative costs have decreased (Messick 1997).

What does all this mean at the level of contract? Greif (1996) contends that the most efficient means of coordination and contract enforcement cannot be determined apart from the specific features of a society, or perhaps even the relevant sub-group. Some societies are more individualist, others more collectivist, with the former tending to develop spontaneous organizations, relatively anonymous exchange, and reliance on formal third-party enforcement to a greater degree than collectivist societies, which tend toward insular groupings, status-based exchange, and reputation or collective punishment as the primary means of enforcement. The optimal size and form of business organization will also vary from one society to another, with the result that the sphere of contractual relations varies in its extent. Importantly, the scope of the functioning social group that limits informal exchange to its members also varies from one society to another, and does not always match what would be economically efficient in the abstract. Like Landa (1994), Greif sees effective intragroup exchange and enforcement as inversely related to

[4]E.g. the U.S. Federal Credit Reporting Act, and similar regimes in developing countries, such as Brazil.

the effectiveness of intergroup mechanisms.[5]

Where the predominance of status-based group exchange limits the range of efficient transactions, as in examples cited by Landa (1994) and Biggs et al. (1997), reforms should address the existence of alternative networks, intragroup efficiency, and incentives toward intergroup exchange, such as formal contract enforcement. Some networks improve contract adherence and enforcement between parties by supplying a regulatory structure that makes relations more transparent and trustworthy (Greif 1996, and Frye 1995). The complication here is that effective intergroup coordination can undercut the rationale of existing groups, and would therefore produce at least short-term group opposition and decreases in efficiency as intergroup mechanisms replace intragroup coordination. This process appears never to have been easy.

As between parties to a transaction or series of transactions, the appropriate coordinating mechanism must deal with the competing demands of planning, of flexibility in dealing with contingencies, and of security in avoiding opportunism and preserving the value of the exchange. One might generalize by referring to the requirement of a workable transaction as being that of "credible commitment." This in turn is shaped by the overall environment--the stability of policy, the quality of the laws, and the functioning of the adjudication system. Continuity of the relationship, that is, the frequency of repeated interaction, also plays a role in establishing credibility. Membership in a business network, or reputation, could provide a kind of substitute for, or supplement to, these two factors. A third factor would be the observability of those indicators of compliance or breach that are to be monitored as part of the transaction, with defined contractual or legal results (Menard 1997).

These transactional requirements yield a range of contractual forms. "Classical" contracts tend to be short-term, relatively devoid of transaction-specific investments, self-contained, and as a result relatively self-enforcing. In other words, discipline is maintained by market mechanisms, with parties using competition, reciprocity, reputation, and sometimes one-shot litigation or arbitration to police each other. At the other extreme are transactions involving tight coordination between parties and highly asset-specific investments, i.e. investment in fixed or custom assets that are either expropriable directly or whose value could be captured through quasi-rents, and whose value in their next available use would be much less than in the current one. Here, the tendency is toward vertical integration, in which those involved are or become part of the same corporate structure, with action disciplined by hierarchical command.

In-between are various hybrid transactions that range from highly "classical" spot-market deals to transactions with long time-frames, asset-specific investments, tight coordination, and a relatively great risk of opportunism. Here, contracts are less self-enforcing than in the "classical"

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[5]A related hypothesis is that business networks act as a substitute for reliable institutional support in the form of contract law and courts. They have a negative externality on the functioning of an anonymous market because they tend to absorb honest individuals, thereby increasing the proportion of dishonest individuals in the anonymous market. Kali (1997)

situation. Repeated interaction, a stable environment, and reputation networks can strengthen credibility and trust, sometimes in the absence of complex contracts. More typically, especially in any situation involving complex investments and high technology, asset-specificity will be high and as a result the costs of contracting increase relative to vertical integration. Where integration does not happen and property rights remain distinct, contracts increase in complexity. There emerges a trade-off between security and flexibility, in which contracts become more complex and costly in order to cover certain contingencies, but only up to a certain point. At that point, the marginal value of further specification declines, and parties rely on "relational" contracting or contractual "governance" to deal with contingencies. This could take the form of mutual dependency and reciprocity based on pre-existing relationships, or the spelling out of governance arrangements and procedures for price-setting and negotiations based on vaguely anticipated future events (as in the case of unit operating agreements in the mineral exploration field), or a combination of the two (Menard 1997, Libecap 1997, Williamson 1995, Alchian et al. 19__, Macneil 1978)

In light of the foregoing, it should be clear how the institutional, policy, legal, and social environment shapes the range of transactions that take place in an economy. Weaknesses tend to cause a decline in intermediate or hybrid transactions in favor of self-enforcing trades or vertical integration. The challenge for policymakers is therefore to strengthen those factors most likely to support the full range of transactions. Most immediately, this means improving legal rules and enforcement options in a way that maximizes the potential for credible commitments by the widest range of transactors.

II.1.3 Processes of Legal Development

How do the necessary rules and enforcement mechanisms develop? Legal systems governing commerce develop through a complex of means, including legislation (statutes and codes), decisions of bureaucrats and administrative tribunals, case law, the absorption of commercial custom and customary law through jurisprudence and other means, and the imposition or adaptation of foreign laws. Tanzania, typical of African countries, had British and Indian legislation and common law superimposed over indigenous and Arab-Persian law and custom. The post-independence period brought about a questioning of this legal heritage, along with other institutions such as the market economy and newly implemented ideas such as representative government. With recent moves toward liberalized markets and effective governance, Tanzania and other countries on the continent have committed themselves, at least rhetorically, to the rule of law once again. However, old habits are hard to break. The tendency to rule by presidential or bureaucratic fiat, and to use law as a tool of power, give way only with difficulty to transparency, accountability, enforcement of commercial agreements, and protection of private property. The need to build power bases and to improve the lives of indigenous minorities, as well as the temptation of elites to engage in rent-seeking, delays and undercuts an effective shift to market relations and the rule of law from one-party socialism.

With such a shift comes a transformation in the process of lawmaking. Laws imposed in

any fashion, whether from within or without, often lack legitimacy. On the other hand, where law stays close to the marketplace, selectively absorbing commercial customs and practices, and where policy is shaped through dialogue between policymakers and encompassing economic interests, law and legal institutions can come to have real practical importance for business people. Law thereby gains "ownership" on the part of potential users, it takes on legitimacy as it is used to shape transactions and defend interests, and it can make market relations increasingly transparent to new entrants as well as outside investors. This means that the process of lawmaking is as important as the content of the laws and the capacity of enforcement institutions.

In order to foster a law-based economy, this process needs to take into account the limitations of the state's monopoly of power. State-derived rules and enforcement mechanisms have a certain reach and utility, but are not the source of all commercial rules. Private agreements, social norms, and informal adjudicatory bodies also create rules that coordinate behavior. These rules supplement and sometimes shape or become part of the state system. When these two systems strongly diverge, oppose each other, or fail to interact --as is often the case where lawmaking ignores commercial reality--then formal systems become a tool for the powerful, and new entrants have strong incentives to avoid them in favor of informality. In this situation, commercial relations become opaque and tend to follow networks of status and patronage (Kahkonen and Meagher 1997).

What one might call "market-augmenting" law evolves from the selective enforcement and absorption of norms created by industrial and merchant communities. Cooter (1994, 1995), using evidence developed by Ellickson (1991), states that social norms in a community evolve toward efficiency. This, in effect, is because the community as a whole has a direct interest in providing public goods, including rules, that maximize general welfare. Communities are usually not so large or heterogeneous as to produce narrow interests that are able to defeat the encompassing interest of the group with respect to efficient rules of property rights and exchange. The paradigm example is the European merchant community of the Middle Ages, which developed commercial rules and enforcement modalities through interaction at regular trade fairs. If law is to augment the efficient working of markets, then it should recognize these rules in some fashion, and enforce them formally as appropriate. This is essentially what happened in England, with the development of centralized common law courts, which took over the adjudicative function from merchants and absorbed elements of the *lex mercatoria* into the common law. This enabled the common law, at least to a degree, to evolve toward efficiency with respect to commercial transactions. By lending the power of the state to the enforcement of social norms, the common law system helped merchants overcome the more difficult problems of coordination--i.e. this tipped the balance in favor of efficient cooperation where this might otherwise have been difficult.

However, as Bernstein (1996) points out, this needs to be a selective process. Once the power of the state can be invoked to enforce contracts and informal arrangements, business communities retain the greatest scope of choice to determine the optimal arrangement when they are able to specify which rules are formally enforceable and which are not. As compared with Article 2 of the U.S. Uniform Commercial Code, which lists custom and course of dealing as

sources of rules in adjudication of contractual disputes, the U.S. NGFA[6] rules provide for arbitration strictly according to NGFA trade rules. This allows parties to allocate aspects of their relationship between legally enforceable and extralegal norms. Such a choice enables them to establish essentially complete arrangements efficiently – for example avoiding the costs of complete contracting and formal enforcement, and using observable but non-verifiable criteria that could not be used in court but could be policed efficiently via reciprocity in a "relational" contracting arrangement. This scheme allows the parties to decide which parts of their relationship are likely to be enforceable, and by what means, for social or efficiency reasons.

It follows that a legal system designed to enable businesses to reap the gains from specialization, productivity, and trade will recognize a wide scope of freedom to contract, will tailor its rules and procedures to maximize efficient coordination, and in doing so will be influenced by rules and procedures developed by specialized private sector communities. This implies the need to develop specialized rules as communities of specialized trade and production firms proliferate, for specialized commercial tribunals to deal with these norms and transactions, and for state-provided laws and adjudicatory mechanisms whose legal relationship to these communities is carefully specified to maximize efficiency--consistent with the achievement of other relevant policy goals.

To what extent does the Tanzanian framework of commercial law and policy meet this standard, and to what extent not? Do Tanzanian manufacturing firms use formal contracts and how are these contracts enforced? This is the topic of the next chapter.

III. CONTRACTING AND CONTRACT ENFORCEMENT IN TANZANIA

To what extent do legal institutions in Tanzania facilitate or inhibit efficient commercial transactions, especially in the area of supply contracts? This chapter analyzes relevant aspects of the system from this perspective.

III.1 Data Used

To assess the quality of Tanzanian legal institutions and practices of contract, primary and secondary data was used. In order to elicit information about contracting and contract enforcement practices in Tanzania, primary data was collected through a small survey of manufacturing firms in Tanzania. Secondary data, such as relevant laws and previous legal on Tanzanian judicial system, was utilized to assess Tanzanian legal institutions.

III.2 Survey of Firms

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[6]National Grain and Feed Association

The survey of manufacturing firms was carried out in July/August 1998 in Tanzania.

The survey focused on three industries: food, chemicals, and wood/timber and furniture. A total of 105 firms were surveyed. Of these firms, 46 were in food industry, 12 in chemicals, and 47 in wood/timber and furniture industry.

The firms surveyed were located as follows: 75 in Dar Es Salaam, 15 in Arusha/Moshi, and 15 in Mwanza. The firms surveyed were selected randomly.

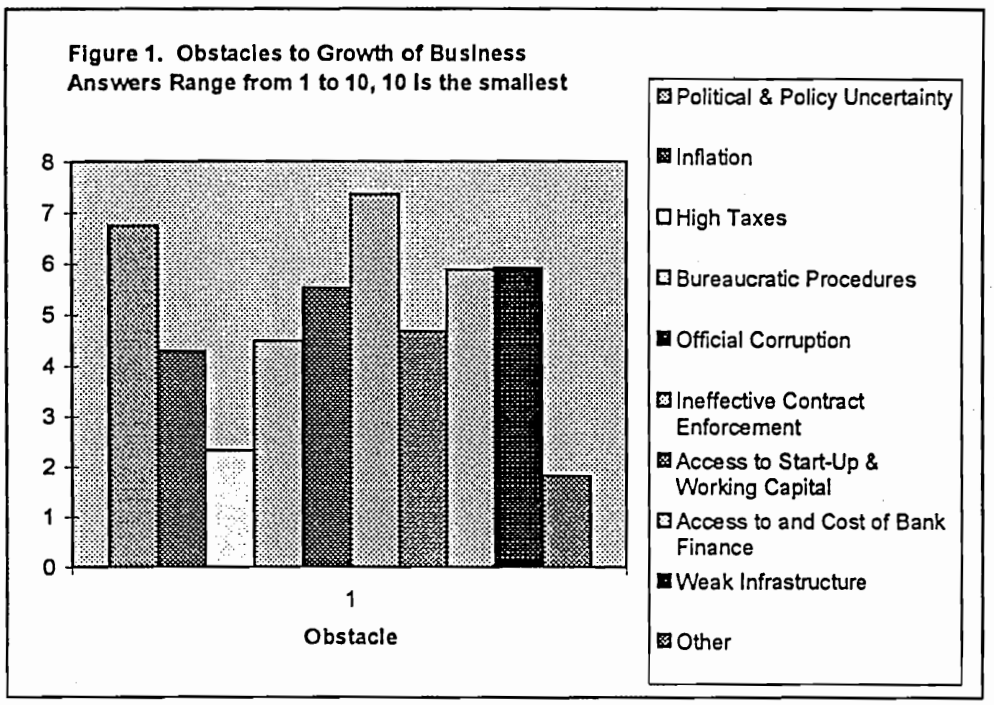
The firms interviewed were generally of small to medium size. Out of a sample of 105 firms, 95 had 100 or fewer employees. The minimum and maximum number of employees in each industry is shown in Table 1. The average age of the firms was 14 years. Sixty percent were corporations or limited liability companies, and of the rest, two thirds were sole proprietorships. Nearly all the firms were privately-owned, nearly 80 percent by Tanzanians. Of these Tanzanian owners, 59% were of African origin, 37 percent Asian, and five percent Middle Eastern.

Table. 1. The total number of full-time paid employees in the firms interviewed

	Minimum	Maximum	Mean
Food	1	440	68.06
Chemical	7	112	44.08
Wood	1	116	17.79
Total	1	440	42.819

III.2.1 General Institutional Factors

Several questions in the survey asked about respondents' experience of, and attitudes toward, aspects of the policy environment and the legal system. Firms were asked to rank a number of potential obstacles to the growth of their businesses, on a scale of one to ten (one being the biggest obstacle and 10 the smallest). As Figure 1 indicates, high taxes were considered the largest obstacle, with 56 percent of respondents ranking this first, and 13 percent putting this in second place. Inflation, access to capital, bureaucratic procedures, and corruption followed in the rankings, in that order. Ranked after these were political and policy uncertainty, ineffective contract enforcement, and weak infrastructure. The modest importance given to contract enforcement problems is consistent with the firms' general satisfaction about their abilities to resolve disputes amicably, as will be shown further below. Interestingly, after the issues of taxes, inflation, and finance, respondents' placed considerable importance on bureaucratic obstacles, with two-thirds giving this a ranking of at least five or higher.



In researching the role of law in the economy, it is important to find out to what extent enterprises use the law in organizing their activity. For example, is there widespread knowledge of the law and use of legal counsel among firms? About 62 percent of survey respondents considered themselves knowledgeable about the law relating to business contracts. However, less than half answered a pair of fairly simple legal questions correctly. At the same time, 42 percent of firms never used legal counsel, and 15 percent used counsel only occasionally. Of those who did use lawyers, about half sought advice on tax or other regulation, one-third used counsel for drafting or advice on contracts, and 17 percent reported seeking legal help for litigation. This is shown in Figure 2.

Figure 2a. Use of legal counsel in business: Food

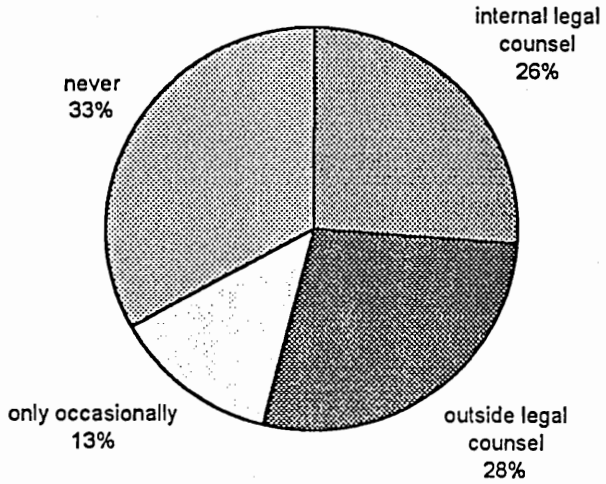


Figure 2b. Use of legal counsel in business: Chemicals

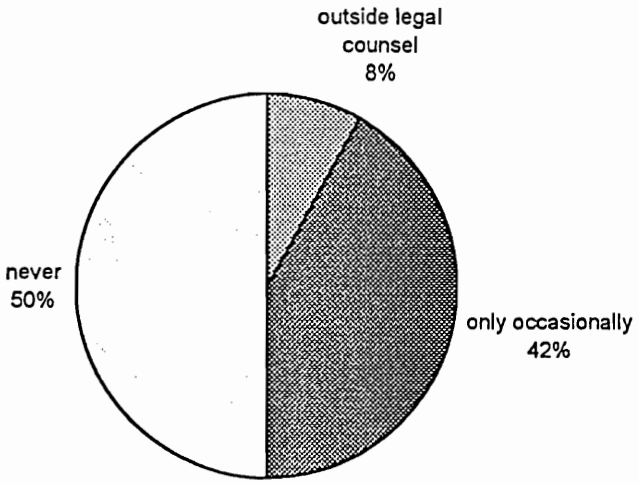
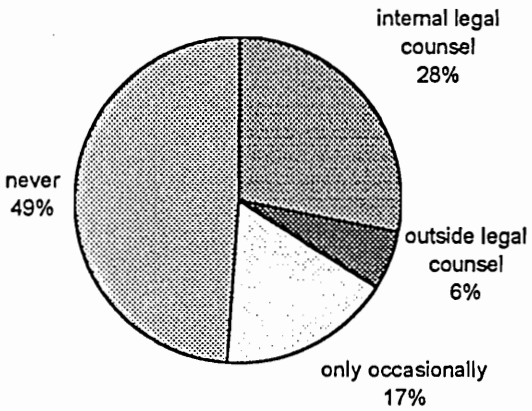


Figure 2c. Use of legal counsel in business: Wood



What has been the nature of the firms' experience with legal system? Only 11 percent said that they had ever gone to court to settle a business dispute. Of these, half had their disputes resolved within two years. The group that had used the courts rated them poorly, as compared to arbitration, with respect to speed and the impact of court litigation on business relationships, but favorably with respect to predictability and the expectation of enforcement. Of those who had considered taking a business dispute to court but did not, the two most important reasons cited for avoiding the court system were fear of disrupting business relationships, and corruption as Table 2 indicates.

Table 2. Were the following reasons for not going to court?

Reason	Yes	No
Would have disrupted the relationship	25%	75%
Would have damaged reputation	13%	87%
Corruption in the court	18%	82%
Difficulties in enforcement of the sentence	5%	95%
Distance to the court	5%	95%
Party cannot be sued	12%	88%
Would not have obtained adequate compensation	4%	96%

III.2.2 Supply Relations and Contracting

The survey focused most of its questions on the methods used by enterprises in coordinating supply relationships and in resolving disputes between suppliers and customers. In

the first category, questions dealt with the basis of business relationships – e.g. status, repeated interaction, or formal agreement. A related inquiry was the extent to which firms favored simple self-enforcing transactions, or more complex transactions involving fixed investments or time horizons that posed risks of opportunism by business partners.

III.2.2.1 Information and Basis of Relationships

A critically important aspect of any commercial relationship is the ability of the parties to screen and select trustworthy partners, and to ensure appropriate performance by those parties. As to the choice of partners, one would expect to find a great deal of anonymous contact and diversity among business partners in societies with long histories of economic stability and specialization, strong legal institutions, and ample sources of information such as credit reporting agencies and securities registries. By contrast, in countries with weaker economies and institutions, and fewer informational resources, one would expect factors of status such as ethnicity or social class, long-standing face-to-face relationships, and reputation within a tight-knit business community to be more important.

The findings indicate that ethnicity may be less important than other social factors in Tanzania. Of firms surveyed, only ten percent said that their principal suppliers or customers came from the same ethnic or tribal group. In light of the sensitivity of ethnic issues in Tanzania and other African countries, as well as past studies of the business community in Tanzania, there is reason to question whether all respondents were truthful. This finding is being confirmed in follow-up research.

In a related question, 38 percent of respondents said that they had come to know their principal suppliers through business associations, while 21 percent said that they had met these partners through personal contacts--i.e. family, friends, locality, or personal recommendations--and 15 percent made the connection via advertising or directories. Figure 3a depicts this. Figure 3b in turn shows how firms got to know their principal customers. This appears consistent with the finding that kinship and ethnicity may not be very significant in the identification of business partners in Tanzania, although social contacts and reputation probably are quite important.

Figure 3a. How did you come to know your principal supplier?

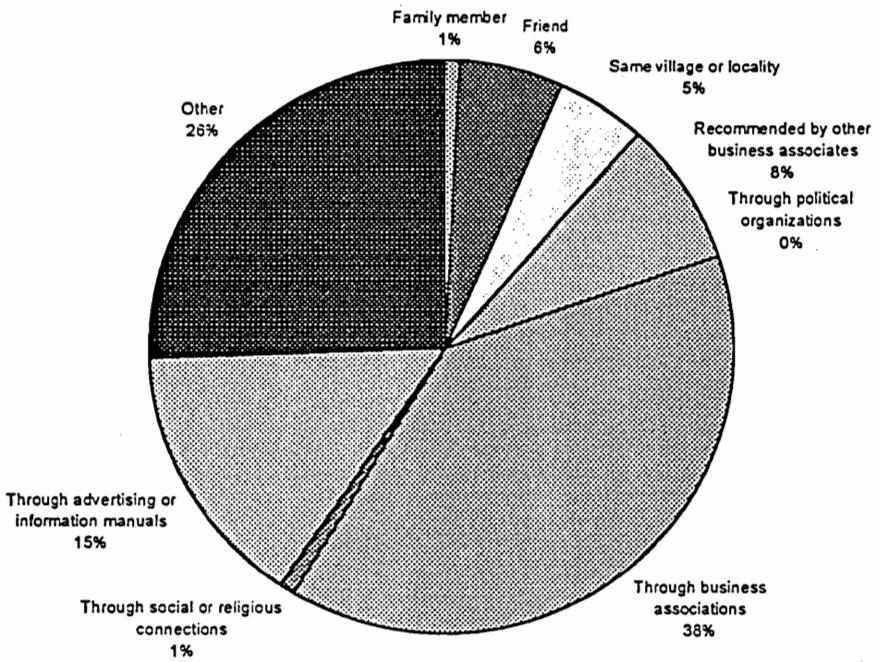
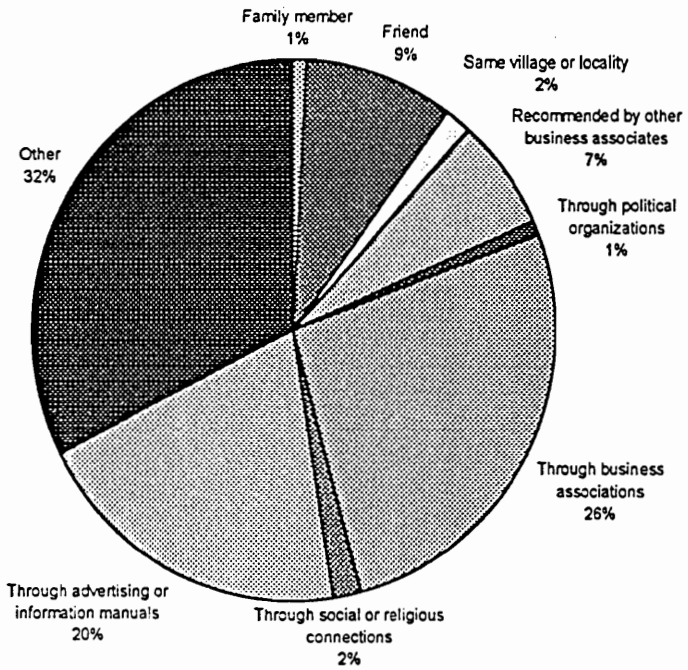


Figure 3b. How did you come to know your principal customer?



III.2.2.2 Bilateral Dependence

Another important form of coordination between transacting firms is the build-up of mutually dependent relationships, in which familiarity begets trust, and opportunism is restrained by the potential loss of a substantial amount of business currently conducted on stable favorable terms. We have seen, above, the relative importance of social contacts and reputation as compared to the identification of previously anonymous suppliers and customers. Once in a business relationship, partners can build trust through long-term repeated interaction.

The Tanzanian firms surveyed knew and had a commercial relationship with their principal suppliers for an average of nine years. Figures 4 and 5 provide information on how long the firms in each industry had known their customers and how long they had had a commercial relationship with them, respectively. In all industries, forty percent of firms had such a relationship with a single principal supplier for over eight years, 32 percent in the case of a principal customer.

Figure 4a. How many months have you known your principal customer?
Food

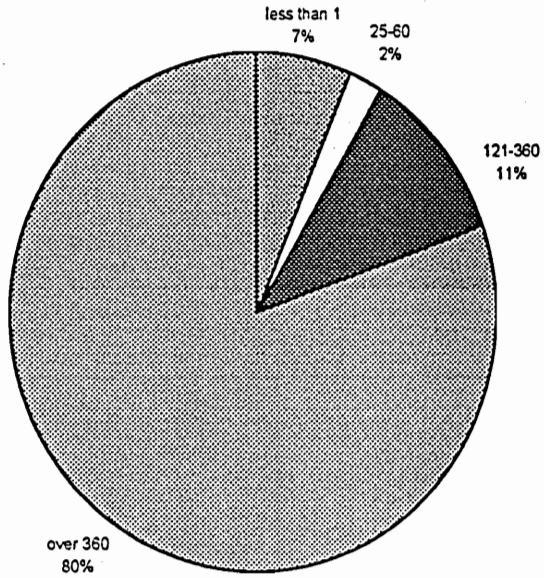


Figure 4b. How many months have you known your principal customer?
Chemical

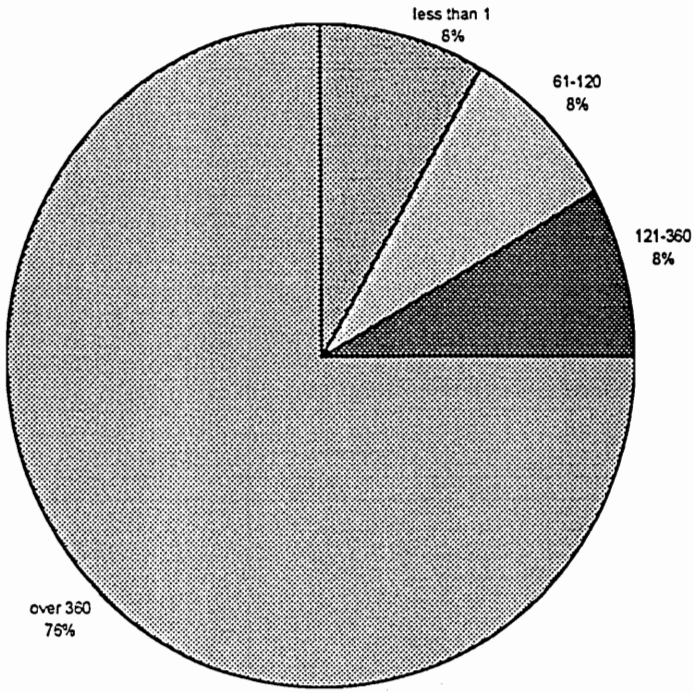


Figure 4c. How many months have you known your principal customer?
Wood

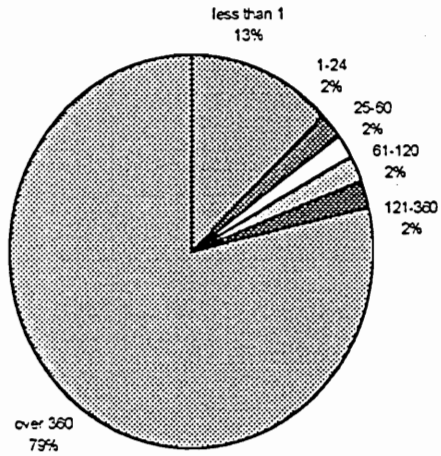


Figure 5a. How many months have you had a commercial relationship with your principal customer? Food

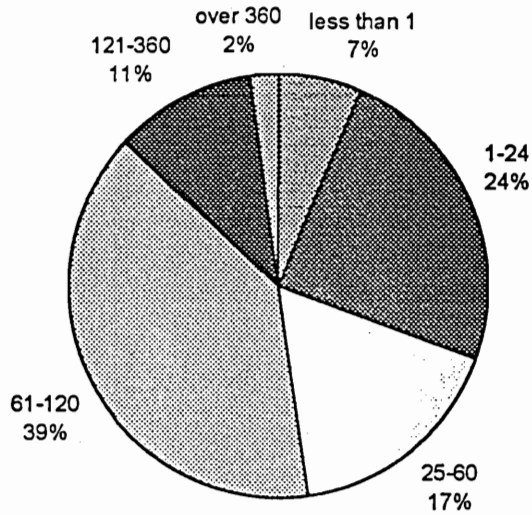


Figure 5b. How many months have you had a commercial relationship with your principal customer? Chemicals

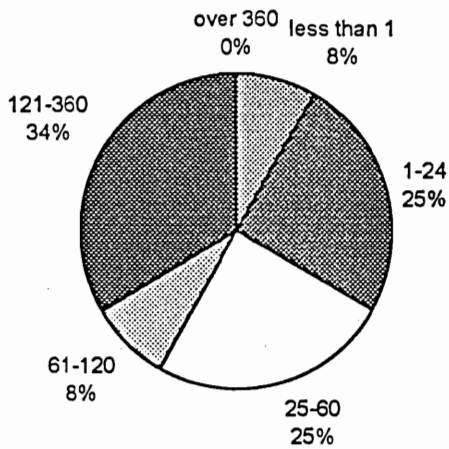


Figure 5c. How many months have you had a commercial relationship with your principal customer? Wood

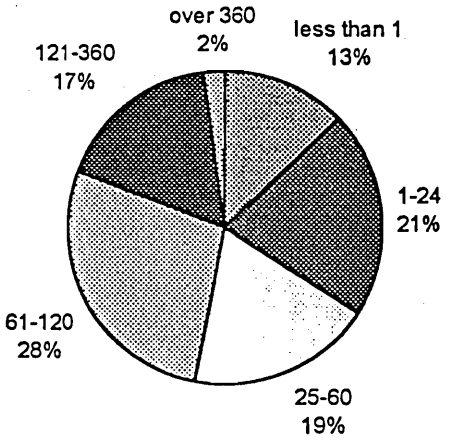


Table 3 indicates that three-quarters of firms relied on a principal supplier for more than 25 percent of their inputs, with more than half relying on a sole supplier for more than 50 percent of inputs. The figures are less stark for principal customers, with 52 percent of firms selling more than a quarter of their output to a single customer, and 21 percent of firms selling more than half of all products to their principal customer. Interestingly, despite this apparent mutual dependency, a majority of respondents characterized the markets for their inputs and products as competitive and said that they could easily replace their main suppliers and customers. Moreover, these close supply relationships between firms did not lead to vertical integration. Virtually none of the firms interviewed said that they belonged to the same corporate structure as their suppliers or customers, nor did they have cross-shareholdings or common board members.

Table 3. Proportion of inputs/raw materials supplied/sold to principal supplier/customer

	Principal Supplier	Principal Customer
Below 25%	25.71%	47.62%
Between 25 and 50%	19.05%	31.42%
Between 50 and 75%	22.86%	10.48%
Above 75%	32.38%	10.48%

These results evidence the critical importance to Tanzanian enterprises of stable long-term relations of mutual dependency. These relations appear largely informal – characterized by neither vertical integration nor, as we shall see below, by much contractual formality.

III.2.2.3 Formality of Agreements

How do firms in Tanzania enter supply agreements, and what do these agreements consist of? Some form of written documentation is generally used, as one would expect: 75 percent of firms reported always using documents, and 79 percent overall used them with their principal customers and suppliers. Five percent of respondents overall reported not using any written documents, seven percent in the case of principal suppliers or customers.

What kinds of documents are used? Most frequently used are invoices, receipts, or bills of lading: overall, 86 percent of respondents used them always or often. Purchase orders are somewhat less frequently used, with 42 percent overall using them always or often, but two-thirds of respondents using them just as regularly with principal suppliers. (Interestingly, as noted above, just under half of respondents believed--correctly--that the dispatch of a purchase order specifying all major terms, followed by delivery of the ordered goods, created an enforceable contract.) Form contracts and transaction-specific written agreements are used less frequently than other documents--in each case, between eight and nine percent overall using them always, and 15 percent using them often or less frequently. These last two types of documents are used far more regularly with principal suppliers than with any other kind of firm—53 percent of respondents reported using form contracts often or always with the main supplier, and 58 percent in the case of tailored agreements. It is possible, as will be discussed below, that relationships with principal suppliers make possible some level of risk-taking, such as the extension of credit or deferral of delivery, which would call for greater specification of terms in writing than would other, essentially self-enforcing, transactions.

Finally, what terms are specified in these documents? About 84 percent of respondents reported specifying the following in documents used with suppliers: price, quantity, quality, date(s) of delivery, and type of payment. A much smaller proportion specified items such as payment schedule, adjustment for inflation, duration of agreement, penalties, and forum for dispute resolution. This is shown in Table 4. Only few specified either penalties or dispute resolution mechanisms. The percentages were lower across the board with respect to agreements with customers.

Table 4. Do you use the following terms specified in written documents?

	Supplier: Yes	Supplier: No	Customer: Yes	Customer: No
Prices	93.33%	6.67%	98.10%	1.90%
Price adjustment to inflation	7.62%	92.38%	16.19%	83.81%
Quantity	95.24%	4.76%	96.19%	3.81%
Quality	80%	20%	81.90%	18.10%
Date(s) of delivery	77.14%	22.86%	80.95%	19.05%
Type of payment	75.24%	24.76%	72.38%	27.62%
Schedule of payment	40%	60%	49.52%	50.48%
Penalties(liquidated damages)	11.43%	88.57%	15.24%	84.76%
Dispute resolution method	6.67%	93.33%	9.52%	90.48%
Duration of contract	11.43%	88.57%	14.29%	85.71%
Other	3.81%	96.19%	3.81%	96.19%

III.2.2.4 Risks Incurred

What do the coordinating mechanisms discussed above permit the parties to do, in terms of risk-sharing and specialization? One indicator of this is the payment terms used. Cash on delivery is the single most favored method, with 33 percent of respondents using this with their principal suppliers, and 48 percent with their other suppliers. The use of credit was the second most common form of payment, followed by advance payments. Checks are infrequently used, and barter virtually never. As would be expected, firms discriminate in the extension of credit – 35 percent of respondents reported using credit with principal suppliers as against 29 percent with other suppliers, and 32 percent used credit with principal customers as compared to 19 percent with others. This is summarized in Table 5.

Table 5. Forms of payment used with suppliers/customers

	Principal Supplier	Other Supplier	Principal Customer	Other Customer
Advance payment	14.59%	10.16%	17.16%	18.24%
Cash on delivery	33.33%	48.44%	28.99%	49.68%
Check on delivery	13.19%	7.81%	19.53%	13.21%
Credit (payment after delivery)	35.42%	28.91%	31.95%	18.87%
Payment in kind	0%	0.78%	0.59%	0%
N/A	3.47%	3.90%	1.78%	0%

What about the time frame over which advance payments and credits are extended? Table 6 summarizes this. Overall, the average time lapse between advance payment and delivery was reported to be 1.3 months, and in the case of credit, the average time lapse between delivery and full repayment was 0.8 months. Thus, despite nearly a quarter of respondents reporting the use of credit, and a similar number reporting the extension of credit, risks appear to be kept small through short delivery and repayment schedules. Even apart from the apparent lack of any medium- to long-term commercial credit, one could reasonably question the existence of any real commercial credit at all, since mean repayment periods are less than a month, and a widely

accepted business standard of "credit" would place the minimum repayment time at 90 days. It is also significant that security is infrequently used for advances and credit, and is largely limited to the proof provided by signed invoices.

Table 6. How much time it takes to be paid/goods to be delivered

	Suppliers: Time between advance payment & delivery	Suppliers: Time between delivery of inputs and repayment
0-.99 months	44.45%	68.75%
1 month-2.99 months	22.22%	25%
3 months-6 months	0%	0%
Over 6 months	33.33%	6.25%

	Customers: Time between advance payment & delivery	Customers: Time between delivery of inputs and repayment
0-0.09 months	31.25%	20%
0.09 months-0.75 months	12.5%	0%
0.75 to 2 months	43.75%	60%
Over 2 months	12.5%	20%

Another indicator of contractual risk and specialization has come to be called "asset-specificity." This refers to investment in transaction- (or party-) specific assets that would be difficult to resell, having little value in their next available use. A majority of firms own or rent warehouses, and with respect to each of the following items, a quarter to one-third had felt obliged to invest in them to lower production costs: custom-made inputs, special-purpose equipment, and special-purpose or retrofitted vehicles. Table 7 provides this information. While these responses are significant, they do not show definitively that these firms have made non-fungible investments based on specific transactions or relationships – further follow-up is needed here and is underway.

Table 7. Are you obligated to invest in fixed assets/equipment to lower production costs?

	Suppliers: Yes	Suppliers: No	Customers: Yes	Customers: No
Custom-made inputs	27.62%	72.38%	25.71%	74.29%
Special-purpose buildings	53.33%	46.67%	42.86%	57.14%
Special-purpose equipment	33.33%	66.67%	28.57%	71.43%
Special-purpose or retrofitted vehicles	27.62%	72.38%	27.62%	72.38%
Other	11.43%	88.57%	9.52%	90.48%

III.2.3 Dispute Resolution and Contract Enforcement

With respect to the enforcement of supply agreements, the survey elicited information on the nature of problems and disputes that have arisen between parties, the variety of ways in which these are resolved, and indications of how the Tanzanian business people surveyed think about adherence to and enforcement of contracts.

III.2.3.1 Nature of Problems and Disputes

A majority, about three-quarters, of respondents reported having problems with their suppliers or customers. Most problems with suppliers ranged from deficient or damaged goods, to late delivery, to non-conforming size or number. The majority of problems with customers related to late payment or nonpayment, and difficulties also included complaints about quality and quantity. In both cases, respondents reported that a significant number of problems arose from transport, weather, or power difficulties. Interestingly, only one-quarter of the firms surveyed reported that these problems ripened into disputes. Among the reasons cited for the fact that most problems did not become "disputes," the most frequently cited were successful negotiations between the parties, a desire to keep good relations, tolerance, and admission of error. In a smaller number of instances, one party was able simply to find substitutes in the market as Figures 6a and 6b indicate. This same desire to work things out and to maintain good relations was found in the firms' strategies at those times where disputes were seen to exist.

Figure 6a. Why problems did not lead to disputes: Disputes with suppliers

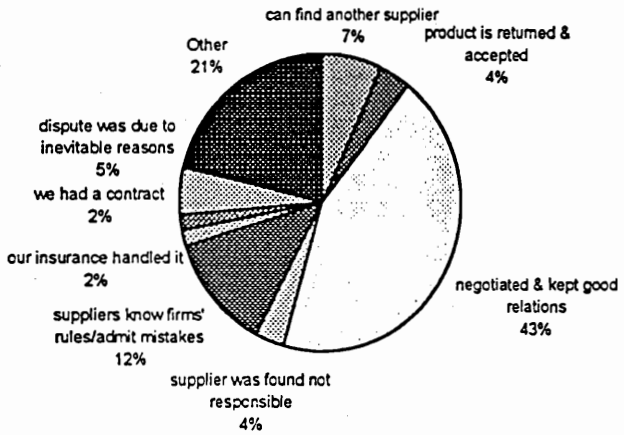
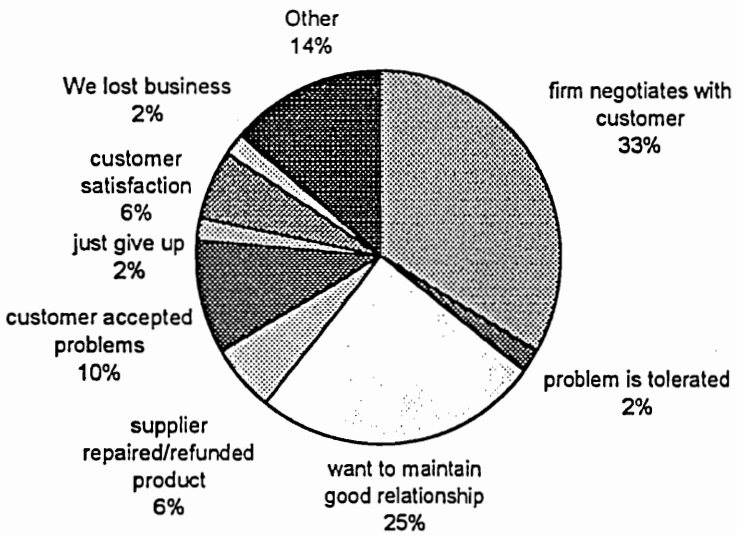


Figure 6b. Why problems did not lead to disputes: Disputes with customers



III.2.3.2 How Disputes are Resolved

Firms were asked about how they resolved the following types of disputes:

(i) With suppliers: late delivery, damage or deficient quality, incorrect quantity, price;
(ii) With customers: late payment, non-payment, quality or quantity problems, price.

What were the most prevalent methods used? Tables 8 and 9 document this information. By far the most frequently used methods involved some form of bilateral negotiation: bargaining, renegotiating the agreement, refusing payment, or threatening to withhold supplies. These strategies were pursued most of the time. The invocation of official channels--threatening to go to the police, threatening legal action, bringing in a lawyer, or going to court--was used in seven percent of the cases. In three percent of cases, respondents used self-help or some form of private arbitration. Interestingly, disputes with customers about late payment and non-payment accounted for all instances in which official channels (police, courts, lawyers) were invoked, as well as most of the cases in which parties used arbitration.

Table 8. Dispute Resolution- How disputes with suppliers are dealt with

	Yes	No
Bargained directly w/ supplier	88.37%	11.63%
Renegotiated terms of the contract	41.27%	58.73%
Refused payment	24.41%	75.59%
Requested a refund if advance payment was used	3.97%	96.03%
Used private arbitration	0%	100%
Undermined the reputation of the supplier	0%	100%
Threatened or went to the police	0%	100%
Threatened to take legal action	0%	100%
Used a lawyer to solve the dispute	0%	100%
Went to court	1.59%	98.41%
Tool the law into own hands (self-help)	3.17%	96.83%
Other	12.12%	87.88%

Table 9. Dispute Resolution- How disputes with customers are dealt with

	Yes	No
Bargained directly w/ customer	73.64%	26.36%
Renegotiated terms of the contract	24.81%	75.19%
Threatened to withhold future supplies	6.98%	93.02%
Used private arbitration	4.65%	95.35%
Undermined the reputation of the customer	1.55%	98.45%
Threatened or went to the police	4.65%	95.35%
Threatened to take legal action	8.53%	91.47%
Used a lawyer to solve the dispute	4.65%	95.35%
Went to court	3.88%	96.12%
Tool the law into own hands (self-help)	3.10%	96.90%
Found a new customer	6.15%	93.85%
Other	6.30%	93.70%

What was the outcome of these disputing processes? The overwhelming majority of respondents (about 90 percent) stated that their dispute was settled, that they were satisfied with the result, and that they were still doing business with the firm that had been involved in the dispute. The one exceptional area here is that of disputes with customers about non-payment. In these cases, about three-quarters of disputes were resolved, and only 38 percent of respondents continued to do business with the party involved in the dispute. As noted above, this area also had an exceptional rate of threatened or actual use of official legal channels. All of these phenomena related to non-payment disputes might be explained by the fact that, in these instances, the supplier had performed and its contractual right to payment had ripened. Informal options that maintain stable relations are relatively few in these circumstances. Lastly, where disputes were resolved, the time lapse involved averaged less than a month. As noted above, among those who had taken a dispute to court, about half managed to have their dispute resolved within two years. The much shorter average time lapse for the full range of disputes dealt with in the survey is probably explained by the overwhelming tendency to avoid the courts and to use informal methods.

III.2.3.3 Tanzanian Approaches to Contract Enforcement

The survey findings reviewed in this chapter provide an indication of the approach that Tanzanian firms take toward supply agreements. Long-term repeated interaction with the same firm is the dominant pattern. Most respondents characterized their relationships with these partner

firms as "friendly" or "trustworthy," and these relationships are usually established through recommendations or other personal interaction. Agreements are infrequently documented by more than an invoice or purchase order, and lawyers are normally not involved. Long time-horizons are rare: exchanges tend to be effected with no more than a month's delay, and commercial credit (defined as 90-day or longer repayment terms) is virtually non-existent. Where problems arise, in the overwhelming majority of cases, parties address them through bilateral negotiation. Courts and other official channels are generally avoided for fear of damaging business relationships or subjecting oneself to official corruption. Indeed, bureaucratic concerns appear fairly important, ranking just after concerns about taxes, inflation, and finance as potential obstacles to business growth.

At the same time, the firms surveyed did not rank weaknesses in contract enforcement as important obstacles to their development. Most felt quite satisfied with their ability to sort out disputes with no third-party intervention at all. The need to preserve stable relationships appears to dictate informal bargaining, compromise, flexibility, and sometimes recourse to alternative options in the market. Indeed, the respondents seemed reluctant to characterize any problem as a "dispute," preferring to regard delays, damage, and nonconformity as normal occurrences, as challenges to be worked out in the most problem-solving and non-disruptive way. This certainly appears consistent with many traditional African lifestyles as well as the old rhetoric of "African socialism" in Tanzania, in which solidarity and tiding-over prevail over narrow insistence on rights. This goes together with the tendency to avoid escalation where possible, resolving differences at the lowest level feasible. Where this appears to break down is in cases of nonpayment, where creditor firms appear more willing to insist on legal rights and to seek redress through the courts and other official channels.[7]

III.3 Tanzanian Legal Variables

III.3.1 Legislation on Contracts and Related Matters

Contract law in Tanzania has several statutory sources, in addition to case law. General principles of contract law are contained in the Law of Contract Ordinance, 1961 (cap. 433), and the Zanzibar Contract Decree. Each carries over relevant provisions of the Indian Contract Act, which was applied to non-indigenous merchants in East Africa during the colonial period. The Zanzibar decree includes sales provisions which were repealed in India in 1930 and replaced in mainland Tanganyika by the Sale of Goods Ordinance, 1931 (Nditi 198_). Also part of the background here is the Regulation of Prices Act, no. 19 of 1973, which made it an offense to sell any goods above the level set by the Price Commissioner (Nditi 198_). Case law is discussed

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[7]Felstiner et al. (1980-1) examine the emergence of disputes, breaking them down into the component parts of perception of the problem (naming), grievance (blaming), and dispute (claiming). They point out the complexity of this process, and the fact that only a tiny fraction of antecedent problems mature into disputes before formal or informal forums.

below.

The Contract Ordinance follows most British common law rules of contract. There are a few differences. One anomaly is its modification of the "mailbox" rule, under which an offer is good upon receipt and an acceptance upon dispatch. The Ordinance provides that an acceptance does not bind the acceptor (but does bind the offeror) until it "comes to the knowledge of the proposer." (Sec. 4(2)) This appears to place contractual duties on only one party between dispatch and receipt (Nditi 198_). Rules similar to those provided under British and American contract law apply to issues of capacity, formalities, consideration, validity, and enforceability (but see the discussion of case law below).

More specific contractual rules applicable to supply agreements appear in the Sale of Goods Ordinance. One striking difference from current practice elsewhere, including the U.S. Uniform Commercial Code (UCC) and commercial codes in many civil law countries, is that the Sales Ordinance applies to all sales, not only those between "merchants." As mentioned above, the advantage of a specialized body of law is that it more easily incorporates commercial usages. Moreover, limiting a statute's applicability to merchants would eliminate equitable concerns about the enforcement of sales agreements against individuals who are not in the business, as well as avoiding entanglement with consumer protection regulations.

Two results are apparent from this. First, most provisions of the Sales Ordinance are spelled out in quite general terms, and lack the specificity of a modern commercial statute. It is possible that specific terms will be spelled out by statutory revision or case law as the private sector develops in Tanzania--although the latter strategy seems risky, given the current experience and attitudes of judges and legal professionals in the country. Second, as will be discussed in more detail below, the courts have a tendency to protect weaker parties, including indigenous firms involved in disputes with foreigners, based on equitable doctrines and paternalistic interpretations of the statute. These are more appropriate to "civil" than commercial contracts. There is also a potential problem with the provision of section 6 that any contract for the sale of goods worth 200 Tsh. or more is not enforceable unless partly performed, or accompanied by earnest money, or documented in a writing. It is unclear whether this provision has been updated to account for inflation. Apart from these difficulties, the Ordinance's rules on price, conditions and warranty, transfer, shipment, rights, and remedies appear generally consistent with the Anglo-American common law of contracts of the mid-twentieth century. Again, the issues are those of competent enforcement and the existence of more specialized bodies of law dealing with commercial transactions.

The Tanzanian Sale of Goods Ordinance although based on common law principles and adopted for the business practices of Tanzania is not conducive to modern day business practices. To illustrate the above point section 6(1) of the Ordinance refers to any contracts for sale of goods worth "200 Shillings" or more. This is an example of the rather out of date nature of the Ordinance.

The United Nations(UN) Convention on the International Sale of Goods and the U.S

Uniform Commercial Code Article 2 are both modern day statutes which provide greater flexibility to the contracting parties, whilst at the same time facilitating easier interpretation of the intention of the parties.

Concerning the provisions relating to description, quality, quantity & fitness the Tanzanian Ordinance in S15 states where sale is by description there's an implied condition goods shall correspond with the description. Section 16a of the Ordinance states if a buyer expressly or impliedly makes known to the seller at the time the contract is concluded, the particular purpose for which the goods are required then the goods must conform with the purpose. A similar provision to Section 16a may also be found in Article 35(2) of the UN Convention. The U.S Commercial Code talks of implied warranties. Article 2-316 of the code goes as far as to state warranties may be excluded or modified in writing. This offers greater flexibility to the parties in their dealings.

The U.N Convention under Article 39 provides more certainty than the Tanzanian Ordinance concerning when the buyer loses the right to rely on a lack of conformity of goods, by specifying a two year period to give the seller notice from the date the goods are handed to the buyer. The U.S Uniform Commercial Code under Article 2-316 provides a variety of ways the buyer may lose his right to rely on implied terms. The U.S Uniform Commercial Code in as well as going into more detail, seems to anticipate various scenarios that contracting parties may encounter in the course of their dealings.

In relation to breach and remedies the Tanzanian Ordinance under Section 50 does not cover this area in enough detail. The U.N Convention under Articles 61,62,63&64 covers the sellers remedies & offers more clarity. A common feature of the UN Convention is allowing the aggrieved party to fix additional periods of time for the party in breach to perform, which tries to encourage commercial activity and give effect to the intention of the contracting parties. The remedy of the buyer for the sellers breach are dealt with by Articles 45,46,47,48 of the U.N Convention. Articles 72,73 & 74 of the U.N Convention tries to cater for various types of breach that may arise and tries to leave open to interpretation only that which is in the interest of the parties. The U.S Uniform Commercial Code is also detailed on the subject of remedies which are dealt with under Articles 2-510,2-601,2-602,2-607,2-608,2-610,2-611,and 2-702.

Damages are covered in detail as well by both the UN Convention under Article 74&75 and by the U.S Code under Articles 2-703,2-706,2-708,2-710,2-711,2-712 & 2-713.The U.N & U.S code both provide how damages are to be calculated, though the U.S Commercial code goes into more detail. The Tanzanian Ordinance under Sections 50&51 mentions damages but it is not clear and does not go into enough depth.

The UN Convention Spends some time on formation of contract. It seems to follow general common law principles on offer & acceptance with some of its own modifications. This is covered under Articles 14 through to 24.The U.S Uniform Commercial code like the U.N code also follows common law principles on offer and acceptance with its own modifications under Articles 2-205 through to 2-207.The Tanzanian Ordinance however does not seem to spend much

time on formation of contract.

Section 10 of the Tanzanian Ordinance deals with where price of goods are not known. Though it does cover various situations, it still leaves some doubt by stating a reasonable price should be paid. A similar provision to this is found in Article 2-305 of the US Uniform Commercial Code. The UN Convention at Article 55 though not covering so many possible scenarios provides more clarity in that it states the price generally charged at the time of the contract for such goods sold under comparable circumstances in the trade concerned should be the price.

There are some provisions which are present only in the UN Convention, which are of importance in a modern day business statute. For example Article 78 in relation to interest, Also Article 77 concerning mitigation. Likewise there are provisions of importance in the U.S Commercial Code, such as Article 2-716 which specifies circumstances specific performance may be decreed as well as containing a liquidation/limitation of damages clause in Article 2-718.Articles 2-721 also provides a remedy for fraud.

Article 42 of the UN Convention relates to intellectual property rights which is an important consideration in modern day business transactions. There does not seem to be any provision like this one in the Tanzanian Ordinance .

Not surprisingly, apart from some legislation implementing liberalization policies since the 1980's, other relevant Tanzanian statutes carry over British and Indian legal rules that are several decades – and in a few cases over a century–old. For example, the Companies Ordinance (cap. 212) reflects an outdated approach in requiring a specific Objects clause, which creates unnecessary (and potentially costly) concerns about *ultra vires* actions. Disclosure and conflict-of-interest rules for company directors and securities dealers are minimal or non-existent. Bankruptcy law does not provide for reorganization and therefore the preservation of "going concern" value and the possibility of a new start (Steptoe & Johnson 1994). The Bills of Exchange Ordinance also dates from the 1960s, and has moreover been undermined by a dysfunctional bank clearance system, among other things. Some of the liberalization policies affect supply relations. Under the Own-Funds Import scheme, an importer now has access to foreign exchange for its own use. The Open General License allows an enterprise to import goods up to a maximum value of U.S. $500,000, provided a corresponding amount of Tanzanian currency is deposited with the Bank of Tanzania. On the other hand, while the Investment (Promotion and Protection) Act, 1990 is perhaps an improvement on what went before, it sets up an unhelpful (and allegedly corrupt) one-stop gatekeeper (ESRF 1997). In short, a core of relevant legislation exists in a somewhat outdated and incomplete form, and it needs some modernizing and supplementation --a need that will become clearer and more urgent as the private sector develops.

III.3.2 Adjudication and Enforcement

The limited confidence of the survey respondents in the court system is understandable in light of the precarious state of the judiciary, its historical subordination, and the current experience and outlook of judges. Nor does commercial arbitration (at least within Tanzania) offer a viable alternative at present. Some improvements are evident since the mid-1980s, but there remains much to be done, and informal substitutes continue to be popular. This section will review salient points of more comprehensive studies of this area.

III.3.2.1 Court System

The IRIS-ESRF survey results indicated large-scale avoidance of the court system by firms. This is supported in other data as well. Collier and Gunning (1997 p. 49) provide comparative data on the use of the legal system for contract disputes. They quote a 1997 study by Widner in which members of the bar in Botswana, Tanzania, and Uganda were interviewed. Only a quarter of respondents felt the judiciary was independent of the executive, and some 20% said the courts came under political pressure. Drawing on several other studies, Collier and Gunning estimate the proportion of inter-firm disputes in which a lawyer is hired at six percent in Cameroon and Ghana, 12 percent in Kenya, 18 percent in Zambia, and 29 percent in Zimbabwe. Our survey data would indicate a figure for Tanzania that is lower than all of these.

Why should this be the case? As elsewhere in Africa, the judiciary in Tanzania was devalued and placed in a subordinate position under socialism. These effects are still being felt today. While the courts avoided the popular tribunal phenomenon that appeared elsewhere on the continent, they were nevertheless subject to one-party dictates like the rest of the governing structure. Some lower-level courts continue to meet on premises controlled by CCM. The practice of private litigation, suppressed during socialism, has not significantly revived. The Tanzanian Legal Corporation was established under the Arusha Declaration policies to provide legal services to the parastatal sector. Few conflicts were taken to courts, as the TLC represented both parties, informal dispute-settlement reigned in the public sector, and (CCM-aligned) judges were reluctant to decide cases between public sector entities (ESRF 1997). When the Court of Appeal of Tanzania was established in 1977, the number of commercial cases it handled was negligible. This increased, however, after liberalization got underway in the 1980s (Nditi 1989).

In the post-liberalization period, the court system continues to be severely underfunded, on a par with the years of one-party socialism. The discrete impacts of this may be individually small, but together they appear to send a powerful signal that the courts are unworthy, and that little can be expected of them. The effects include seriously dilapidated and crowded premises, lack of materials and furniture, lack of trained personnel with resulting disorganization and loss of files, growing backlogs at the lower levels, assessors and witness who are fail to appear for lack of payment, and underpaid judges. That the court system lost ground budgetarily, vis-a-vis other function of government, is a further signal of its unimportance (FILMUP 1994).

Structural problems are also important. A serious imbalance exists in the case loads of the different first-instance court levels. Objections have been noted with respect to the power of primary court judges, who are essentially untrained and are instructed by untrained assessors.

Customary law disputes touching on contracts can be brought before the Primary Courts, but jurisdiction at this level was restricted by the Magistrates Courts Act, 1984, to disputes involving up to 10,000 Tsh. It is unclear whether this figure has been adjusted for inflation (Nditi 198_). Even at the High Court and Appeals Court level, where there are trained jurists and where backlogs have begun to shrink, there are serious problems. Similar issues of overcrowding, lack of resources, and administrative disorganization exist. Moreover, the rules and practices followed in appeals unduly prolong cases and tax the resources of the courts. Counsel do not appear to be required to prepare useable written submissions in advance. Procedural rules allow the courts wide discretion to reserve judgments, and judgments are routinely reserved, for days or weeks, even where the outcome is a foregone conclusion. At the High Court level, no more than two percent of cases settle after a suit has been filed, as compared with a 90 percent rate in England and Wales (FILMUP 1994). Ringo et al. (1995) show the impact of inadequate information networks and enforcement procedures in the financial market: borrowers make multiple pledges of the same assets, and lenders do not have access to self-help or expedited execution procedures under the law, but must bring a new civil action to enforce a debt. This is commercially unreasonable. Clearly, procedural rules and court practice have failed in their essential task of weeding down potential litigants to those whose cases cannot be settled out of court. Proposals are under consideration to address these issues.

Another important problem, reflective of the political legacy, is the judiciary's attitude toward its mission. Tanzanian courts are said to regard themselves as having a duty to protect those who are "poor and less fortunate." In this, they have essentially interpreted the common law and statutes governing contracts in light of the policies implemented under the Arusha Declaration. In the case of *Sluis Brothers (E.A.) Ltd. v. Mathias and Tawari Kitomari*, the Court of Appeal of Tanzania found in favor of a local company that contested its seed-growing agreement with a Dutch company, under the equitable doctrines of unconscionability and *non est factum*, the latter having been originated to protect illiterates. The agreement was in English, which the Tanzanian defendants could not speak proficiently, if at all. Here, the court protected the Tanzanian defendants from the consequences of a signed form agreement, which they had misunderstood not to be a seed production agreement but a joint venture (ESRF 1997, Nditi 1989).

The Tanzanian courts have been found to take a flexible view of the law. Section 10 of the Sale of Goods Ordinance (cap. 214) states that where a sales contract does not state the price the buyer must pay a reasonable price--a question of fact to be determined in the circumstances. In the case of *Alfi E.A. Ltd. v. Themi Industries*, the Court of Appeal did not apply this rule, finding that the price is a fundamental matter, and since no price was agreed, there was uncertainty and therefore no agreement existed (ESRF 1997). In other cases, the Court has chosen not to apply formal requirements where this would harm the weaker party.

An indication of the legal thought animating the Tanzanian courts is provided by the introduction to a contract law text, apparently written at the University of Dar es Salaam in the 1980s and still in use. It reads in part:

All class societies--those in the Slave Mode of Production, Feudal Mode of

> Production and the Capitalism Mode of Production--are characterized by the propertied classes' urge to acquire more and more through exploitation of the labour of the non-propertied classes. Central to acquisition is exchange of values. Less value for more value; buying cheap and selling dear, a month's work for meager wages, and it is contract which facilitated exchange of values...
>
> [T]he two fundamental notions, i.e. sanctity of contract and freedom of contract form part of the bourgeois ideology and are "false consciousness"....
>
> It is necessary to persuade people into all these things in order that they accept to be exploited, and minimize incidences of open conflicts arising out of the capitalist mode of production.[8]

If these sentiments are still prevalent, at least among the intermediate and older cohorts of the bar and judiciary, there is little wonder that the legal system suffers from a lack of credibility among entrepreneurs. To overcome this and the other problems noted above, the most direct solution would be to make specialized commercial tribunals available to hear business disputes. One aspect of this would be the rapid establishment and training of personnel for these courts in Tanzania. Another would be reestablishing limited recourse to the Privy Council of Great Britain, at least until there has been significant improvement within Tanzania. Even Singapore, also a republic within the Commonwealth, has retained this option. (FILMUP 1994 p. 50) These options are discussed further below.

III.3.2.2 Arbitration and ADR

The survey results indicate that commercial arbitration is used even less than recourse to courts of law. Other Alternative Dispute Resolution (ADR) mechanisms are not officially recognized or used in Tanzania – indeed, the choice appear to be limited to bilateral negotiation and litigation. The Arbitration Ordinance (cap. 15), as with other commercial legislation, reflects British and colonial practice of several decades ago (although the Ordinance is said to have been revised in 1974). A review of the Ordinance by a U.S. law firm concluded that it "does not create an environment hospitable to arbitration." It reflects developments in international arbitration up to the 1930s, but has not been amended to reflect Tanzania's accession to the 1958 New York Convention on the Recognition of Foreign Arbitral Awards, which requires mechanisms for expedited enforcement of awards made in member countries. The study also found its provisions concerning arbitrations to which the government is a party inadequate, and recommended updating the Ordinance to reflect both the New York Convention and the ICSID[9] Convention rules on waiver of sovereign immunity (Steptoe & Johnson 1994b).

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[8]Nditi (198_) pp. 2-3.

[9]International Center for Settlement of Investment Disputes

Perhaps most importantly, under the Ordinance the courts retain wide discretion to avoid the enforcement of arbitral awards. This is a fundamental problem for both domestic and international arbitration, because it calls into question the reliability of enforcement and therefore the utility of pursuing arbitration. The Ordinance allows a court to refuse to stay judicial proceedings begun in violation of an arbitration agreement if it believes there is "sufficient reason why" the proceeding should not be referred to arbitration. Moreover, arbitral awards can be overturned on fairly vague grounds of "misconduct" and "misinterpretation" by the arbitrators. This conflicts with modern practice of narrowly delimiting these grounds, by statute or case law. Disputes that are subject to arbitration are narrowly limited, in contrast to current practice elsewhere, in which the cases where arbitration is not permitted are specifically defined exceptions to the general rule that disputes are arbitrable. Finally, in contrast to modern practice elsewhere, Tanzanian law does not recognize other forms of ADR, such as mediation and mini-trials (Steptoe & Johnson 1994b).

As a result of these statutory weaknesses, and of practice during the socialist period, arbitration and ADR do not currently fulfill their function of channeling problems and disputes into the least costly and most efficient forum for dispute resolution. Also, along with a severe shortage of qualified judges and attorneys, there is a virtual absence of trained and experienced arbitrators (FILMUP 1994). The confidence of domestic and international firms in the utility of arbitration in Tanzania is therefore virtually nil. This places considerable pressure on parties to either forego investments, specify all contingencies in their agreements, ensure that transactions are self-enforcing, resolve problems through bilateral negotiation or other informal and ad hoc means, or escalate disputes rapidly to the level of the courts. This reflects neither a good range of dispute resolution options nor an efficient use of resources by the parties and the courts.

III.3.3 The Rule of Law

The rule of law is not firmly established in Tanzania. The overlay of colonial law created a top-down approach to legality, and even this lost ground after independence. With liberalization, multiparty elections, and a growing emphasis on public sector integrity, however, the tide may be starting to turn. Still, much remains to be done. An EDI (1997) survey of public experience with the judiciary, lands, and revenue services indicated continuing problems of corruption, lack of transparency, and absence of a public service ethic in the government. There remains a sense that traditional constituencies of the old ruling party, including bureaucrats, unions, local cadres, and many (especially formerly state-owned) industrial firms, will be protected through informal, even corrupt, means. This paramount signal of continuity with the old order is not consistent with the desire, evident among much of the private sector and progressive leaders in the Mkapa government, for a state and an economy governed by a liberal, responsive, and honest legal and constitutional order.

It follows from what has been said above that the private sector in Tanzania has not placed great reliance on the law as a means of coordinating production and trade, and of resolving disputes. Practice under socialism stressed bureaucratic intervention, production and trade by the state, and the use of influential connections. The practice is still widespread among the

population of taking (extra-familial) disputes to the head of the ten-household cell, and to CCM party leaders. This is in part encouraged by a tradition of avoiding the outbreak, and the airing in public, of disputes – which are best headed off or handled within the relevant community. Businesses are not entirely different, although some are able to obtain positive results for themselves through connections or by means of corruption. This has begun slowly to change, however, in the more liberalized economic environment of today- especially among newer firms and those oriented towards external trade (Lofchie 1995).

For example, Ringo et al. (1995) found that small and medium enterprises often do not use formal agreements. However, they do tend to rely on formal contracts in certain sectors with established contractual practices: public works, transport of goods, and insurance. Here, both the law and frequent and longstanding practice have created relatively specialized bodies of commercial know-how, with a limited and well-known set of specific contracts having come into use, and in some cases (e.g. public works), specialized statutory and dispute resolution schemes. These fields might be worth further study as examples of emerging legalism in the private sector, as pilot fields for the further development of specialized commercial law and ADR mechanisms, and as potential models for other fields.

In short, commercial contract enforcement exists within a context of public sector governance and private attitudes towards the law as a set of coordinating, and protective, institutions. In Tanzania, weaknesses in this area are pervasive and have grown during recent decades, although economic and political transformations are beginning to put pressure on the system to change. What are the most important changes that our analysis suggests? This is the topic of the following section.

IV POLICY IMPLICATIONS

The implications of the preceding discussion for policy and institutional change are many. Here, we suggest those that seem to be most directly related to our findings, and of most pressing importance.

The broadest overall implication is the urgent need to establish, or re-establish, the rule of law and transparent public sector governance. The scope of this is vast, and includes placing the independence of the judiciary on a firmer foundation, upgrading the skills and image of the judiciary, strengthening administrative procedure, implementing civil service reforms that change the incentives and outlook of the bureaucracy, and ensuring legal and policy stability through a functioning array of checks and balances between the chief of state and parliament. Other more specific reforms relating to commercial transactions are unlikely to achieve much in the absence of this more fundamental improvement. Countries with poor governance suffer a drag on investment and economic growth (Mauro 1995). This can happen via bureaucratic barriers to entry, dishonest and costly administrative actions affecting the life cycle of enterprises, policy and public expenditure distortions, uncertain allocation of property rights and public goods, and unpredictability in the adjudication of private disputes. As we have seen, these problems can

place enormous additional risks and costs on potential investors. The priority of these matters for Tanzania should be obvious.

On the level of legislation, there are a number of needs, some more immediate than others. An early priority would appear to be updated legislation on court structure and procedure, arbitration, and other forms of ADR. The Tanzanian legal system fundamentally fails to channel disputes into the most efficient forums for adjudication. In doing so, it overtaxes its judges, strains the capacity of the court system, increases the costs to litigants, and plays a large role in creating uncertainties and in undermining the value of investments. Serious consideration should be given to making specialized commercial tribunals, with highly-trained personnel, available for the resolution of business disputes. One rapid step in this direction might be to allow parties by contract to specify that appeals can be made to the Privy Council in London. In any event, there is an urgent need to change the culture and economic orientation of jurists handling business disputes, and to ensure that the process is clean.

Commercial arbitration and ADR are also of critical importance. The Arbitration Ordinance, at a minimum, needs to be revised to reduce the discretion of the courts with respect to stays of judicial proceedings and enforcement of arbitral awards. Similarly modernized rules can be annexed to the Ordinance by way of recognizing and providing support for other types of ADR – mediation, mini-trials, or other means, as appropriate. Some existing informal methods might be incorporated into this scheme and upgraded. These steps to rapidly improve the quality of commercial adjudication and procedure would send a signal of credibility to the business community, and would constitute an important move toward the rule of law.

A second important set of legislative priorities involves changes to commercial legislation. First, controls on prices and other issues affecting contracting, from the socialist period, should be eliminated as soon as possible. Obviously, commercially reasonable warranty and consumer protection provisions are still needed, but these need to be embedded in a context of market-oriented law. Further, modernizing the Sale of Goods Ordinance, as well as outdated provisions of company, finance, and bankruptcy laws is needed. The revision should aim at creating a Sales law specifically for business transactions, incorporating contemporary international practice concerning documentation, warranty, trade finance, shipping, insurance, etc. This should be the cornerstone of a developing edifice of specialized business law, which would be accompanied by trade and arbitration rules specific to each of Tanzania's dynamic sectors, e.g. transport, public works, food processing. This, in turn, implies a more ambitious role for business associations, both umbrella chambers of commerce, and perhaps more importantly in future, sector-specific organizations. Contact, exchange, and perhaps assistance from counterpart organizations abroad would help in this undertaking.

Enabling the improvement of business associations would require not only increased cooperation and capacity at the level of the associations, but would also require some prior change in legislation and procedure. For example, it would spur the creation and development of sectoral associations that articulate their own rules and procedures if they had clear status at law. The Sale of Goods Ordinance does recognize custom and course of dealing. This may need to be

spelled out more clearly, perhaps in the case law. Additionally, the government should continue to clarify its support for NGOs and business associations taking on civic responsibility, self-organization, and the provision of public goods such as information, rules, and procedures within their domain. Clearly, this needs to be actively cultivated, given the public sector's tendency to preempt all fields during the socialist period.

One especially critical area that will need private action with some public support is the development of more extensive business networks and information systems. In the absence of a much greater level of regional market integration in Africa, the size of the Tanzanian market is unlikely any time soon to allow for the emergence of indigenous financial rating and credit reporting services. Business networks, and to a limited extent some public facilities, will need to take up the slack. Industrial firms have strong ties to long-standing partners. The picture is probably different among smaller firms and trading companies. In any case, the ability of firms to screen and police partners or potential partners on the basis of reliable and widely available information would have an important impact on the range of a firm's contracting partners. Government can help by ensuring the efficient and accurate working of commercial, lien, land, mortgage, security, and other registries that provide information on firms, transactions, and assets. Some of these appear to work very badly and may require some creative public-private partnerships to achieve substantial improvement. Apart from this, there may be ways to enable business associations or quasi-public firms to obtain and disseminate financial and performance information by strengthening and enforcing disclosure requirements, and by facilitating the access and sustainability of these information providers until such time as the market for this information is well-established. This, along with improvements in governance, law, and adjudication, is an important component of an efficient commercial transactions regime.

How will it be possible to make such changes? Pinheiro (1996) points out that reforming a legal system, and especially the judiciary, often faces difficult obstacles. First, society is relatively adapted to the status quo, and alternatives appear risky and ill-defined. Second, the costs of reform are fairly clear and concentrated, while the benefits are spread across society as a whole. Groups that stand to lose from reform include court system personnel and others who profit from expediting (or corrupting) the judicial process; providers of substitutes such as trade intermediaries and informal mediators; the bar; and firms that benefit from a dysfunctional system such as entrepreneurial cronies of powerful officials, monopolies, and those seeking to avoid taxes, contractual duties, rent payments, etc. Societies have overcome these obstacles to collective action in the past. The process has sometimes been consistent with stability and public order, sometimes not. Any such change requires dialogue, and usually conflict and negotiation, between encompassing constituencies of the private sector and the government or governing elites. There are some hopeful signs in Tanzania of reform commitment in the government as well as interest articulation by the private sector. The former needs to be more firmly established and extended; the latter needs to include newer firms and entrepreneurs; and these two processes must increasingly interact in order to build a law-based economy. If Tanzania does not attend to this sooner, then the pressure of a globalizing economy, of the international financial institutions, and of the donors that have sustained Tanzania in the past are likely to force a change later, in more dire circumstances.

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THE CONTRIBUTION OF BUSINESS LINKAGES TO THE GROWTH OF PRODUCTIVE EMPLOYMENT AMONG SMMES IN SOUTH AFRICA: APPROACHES AND PRINCIPAL FINDINGS TO DATE

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A. INTRODUCTION

This is an interim report on research work in progress, about half way through the activity. Its focus is on vertical linkages, primarily between large buyers and small suppliers, as a mechanism for the promotion of productive employment among historically disadvantaged enterprises. The research is taking place in three locations, with different researchers involved at each location: in Pietermaritzburg (Prof. Ed Bbenkele, Prof Tom McEwan, Mr. Barry Strydom, Mr. Moses Ndlovu and Prof Donald Mead); in Durban and Richards Bay (Mr. Owen Skae); and in the Northern Province (Dr. Charles Machethe and Dr. Francis Anim). The researchers in each location have taken a somewhat different approach, reflecting their own interests as well as the economic circumstances at that location. We have produced a common interview outline - not so much a questionnaire as a guide for interviews - which provides a common starting point for discussion and analysis in all locations. To date, in the three locations, interviews have been completed with over 50 buyers, with over 40 suppliers, and with 10 institutions engaged in linkage promotion activities. In some cases (particularly with buyers), we have had several interviews with people with different responsibilities in the enterprise.

The following three sections provide brief reports on approaches and results to date: one focusing on linkages in the traditional medicine sector, written by Prof. Ed Bbenkele of the University of Natal/Pietermaritzburg (section B); one exploring linkages in the Durban and Richards Bay area, by Mr. Owen Skae of the University of Natal/Durban, (section C); and one looking at the role of two development agencies in the promotion of linkages in the Northern Province, prepared by Dr. Francis Anim of the University of the North (section D). This is followed in the final section by some more general comments by Prof. Donald Mead, who is the overall supervisor of the project.

B. Economic Development through Business Linkages in the Traditional Medicines Sector.

1. Introduction.

This study investigated the business linkages in the traditional pharmaceutical industry. The main activities of interest consist of the group of muthi gatherers and the pharmaceutical companies which use traditional herbs in manufacturing medicines. The muthi gatherers usually sell unprocessed products, partially processed products (roots, tubers, branches, and bark), and processed products (unmixed chopped and ground bark). These products which amount to 490 - 730 tonnes per year in Durban are sold to traders, herbalists (*izinyanga*), diviners (*izangoma*) and consumers. When different plants, herbs, and roots are mixed, the end product is the muthi medicine. When a pharmaceutical company manufactures say *Bangalala* mixture by using the *Bangalala* root as the main ingredient and adds on vitamins, flavours and preservatives, the product is usually unregistered and referred to as a traditional medicine.

Information was collected from the Managing Directors of six major companies. To complete the study, several other pharmaceutical companies, the Medical Control Council and representatives of the various Traditional Healers and Herbalist Associations and the actual individual suppliers will be interviewed.

Of the companies seen so far, all of them except one used traditional or indigenous plants and herbs as inputs in manufacturing unregistered traditional medicines and in some cases registered medicines[1]. Kirch is a distributor of imported pharmaceutical raw materials and sells to all pharmaceutical companies in the Industry. Adcock is one of the leaders in the industry but only uses the cape aloe in its production process.

Pharma Natura is in herbal preparations and grows 80 herbs it uses in production at its farm in Graskop. In addition, the Company has planned an investment of about R6 million in the production of herbal African medicines.

The other companies are old , (for example Marshall Chemicals is sixty - six years old), much smaller in size, and in all cases passed down in the family . However, the sons who currently run these companies are all required by the Medical Control Council to be pharmacists and indeed they are all highly specialised pharmacists. These companies also seem to carry a wide product mix. The typical product mix includes cosmetic, registered medicines and traditional medicines. Marshall Chemicals, for example, produces a total of sixty-nine product items in the muthi range. In addition to this, there are thirty one product items in the Marshall range, twenty-one in the Du Toit's Dutch medicines, six in the "77" range, nine in the general, six ointments, five children's range, and four tablets. Most of these registered product items use traditional herbs.

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[1]Registered medicines are those which pass clinical tests and registered with the Medical Control Council (MCC) whereas the traditional medicines do not need any clinical tests and therefore unregistered by the MCC.

GM pharmaceuticals is mainly in products relating to "Love". It produces a very wide range of such syrups, pills, capsules, mostly aimed at increasing sexual potency or pleasure, and sells condoms for another company.

2. Do Linkages Exist and What Type of Linkages would be most Appropriate in Fostering Economic Development in the Pharmaceuticals Industry?

In the pharmaceutical industry, it was hypothesized that there would be no linkages. This can be explained from the fact that the gatherers of traditional medicines were considered to be very peripheral to be active participants in the pharmaceutical industry due to their sizes and market sophistication. They can be correctly identified as survivalists.

Despite their smallness and relative insignificance, a simple model was conceptualised on how they could be integrated into the marketing system. This model is basically very simple and suggests that for the gatherers to operate more efficiently, it is important to link them in an effective way into a marketing system which is efficient. Translated to South Africa, the system should encourage the muthi gatherers to come together to form producer and buying cooperatives. The main functions of the producer cooperatives would be for the gatherers to grow and deliver the traditional plants and herbs in the right quantities, at the right quality, at the right time, at the right price and place to a middleman or directly to the manufacturers. The manufacturers would then add value by processing the raw materials into an accepted standard both for the registered and unregistered medicines or making final products.

If this is realised it would greatly improve the efficiencies in the market networks where they exist and increase the base of economic participants in the *muthi* gathering sector. For the conservationists, this would result into a significant contribution in solving the problem of deforestation , a problem which has been in existence for a long time, since uncontrolled gathering seems to result in deforestation.

This model which has worked very well in Thailand also seems to be workable in South Africa and this is what gives hope for the economic empowerment of the survivalist traditional sector (gatherers) in South Africa. From secondary sources, it seems that 70% of the blacks in urban areas use traditional African medicines. The market seems to be existing and growing due to urban migration.

2.1 Yes! Linkages do exist but in Different Forms.

The companies described above are all highly formal and their workers belong to the Pharmaceuticals Union which is affiliated to COSATU. This means that minimum employee retrenchments can be done by these companies without getting into union problems. More so, it is easier for the companies to link with suppliers of raw materials than to engage into serious black empowerment programmes of out sourcing. In fact , of the companies interviewed, there

was none which established out sourcing or had purchasing policies which favoured the historically disadvantaged businesses. All the business networks seemed to be motivated strictly by economic decisions. Almost all the companies were prepared just like any other companies to out source most of their non core activities like security, cleaning, gardening, catering and laundry. But over and above these non core linkages, companies interviewed were in one way or another directly engaged in core business linkages focusing on their raw material supplies, and these are explored in this report.

2.1.1 The Muthi Gatherers as Suppliers of Raw Materials for the Export Market.

The first type of business linkage identified involved the supplying of traditional herbs in the form of roots, tubes, leaves barks etc. to export markets for further processing of raw materials or finished products. In one case, *cape aloes* are grown in the Cape province, exported to Europe for processing and bought for use as raw materials by the pharmaceutical companies in S.Africa in the production of laxatives etc. The main reason for this circuitous route was to meet the quality standard requirements imposed by the South Africa Medical Control Council. This requirement extends further to require the suppliers of raw materials used for the registered medicines to be approved by the Medical Control Council. However, it would seem that this does not hold for the supply of raw materials for the production of traditional medicines. For example the *devils claw* is imported in the raw form from Namibia and Botswana by many pharmaceutical companies for use in making traditional, but not registered, medicines.

One point which should be made here is that the *cape aloes* is a plant which grows in the wild and can also be cultivated. Adcock was willing to assist gatherers to grow the plant, buy it from them and export it to Europe for processing or to process it locally to reap the full economic benefits (This needed technology to meet required standards). Just as cut fresh flowers have been a top export product for most countries in SADC, the Managing Director of Adcock believes that traditional herbs could be hot exports as America and Europe are shifting to alternative medicines (natural herbs). The industry hence opens a lot of export opportunities in the non traditional exports which could be driven primarily by the muthi gatherers.

2.1.2 Traditional Gatherers as Direct Suppliers to Manufacturers.

The second type of linkage involved a few muthi gatherers selling the traditional herbs to companies which are directly involved in the manufacturing of traditional medicines. Marshall Chemicals buys directly from the muthi gatherers who from time to time come to their factory. These gatherers brought herbs which were in season and sold them to the company. In this case, due to seasonality the company did not have a choice but to buy or wait until the following year. Hence, in a sense the market is controlled by the suppliers. Hence, this could give the suppliers slightly more power in the exchange for some of the seasonal products.

Marshall Chemicals revealed that most of these gatherers were *Inyangas* from Natal and Gauteng. As some of these raw materials are very similar, the company has employed a traditional healer who sits in a "dark office" as the "Purchasing Manager " cum " Production Manager" for the production of the traditional medicines. The traditional healer ascertains whether the herbs are the right ones and also determines their quality levels. Apparently, in this

sector, it is important that certain herbs are harvested at the right times of the day to allow for maximum ingredients to be retained. For some others, it is believed that certain rituals have to be performed to preserve the potency of the herbs. This role is fulfilled by the traditional healer in the company who is a very articulate person and interacts very well with management. These linkages are ignored by the Medical Control Council simply because the traditional medicines are not registered medicines.

2.1.3 Traditional Medicine Gatherers as Growers.

The third type of business linkage is the one which is very central and this involves getting the gatherers to grow the herbs in their fields and to sell these to the manufacturers. In this respect, Pharma Natura currently imports some herbs from overseas like Scheuder bitter , for liver problems, Ottomisia for treating Malaria as the mosquitoes in Africa have developed immunity to the current malaria drugs, and Iscador to be used for the treatment of AIDS as a joint venture among WITS University, California and Berlin Universities. This raw material has attracted R5 million investment money for the medicine to be used on a trial basis on 180 patients.

All these inputs of traditional or indigenous herbs and some other seventy similar ones are grown on the farm of Pharma Natura at Graskop. As pointed out above, Pharma Natura Company manufactures herbal preparations, vitamins, and homeopathic medicines. The Managing Director welcomed out sourcing the growing of the traditional herbs to the gatherers. In this respect, he was prepared to assist in the training of the gatherers in the methods of cultivating the herbs which he understood not to be a complex process as some sources make it to be.

Hence, this business linkage is all-embracing as it seeks to obtain the necessary inputs by out sourcing the growing of these to the gatherers, processing these inputs and selling them to other manufacturers who need the inputs. It seems that this will be feasible as the company is currently engaged in growing these herbs. The Managing Director has fully embraced the idea of getting the traditional gatherers of herbs to be fully involved in growing the herbs and selling them to the company to expand the raw material acquisitions for it's envisaged R6 Million herbal medicines plant (this would be in addition to the seventy herbs it currently grows at it's farm at Graskop).

3. Which Types of Linkages are More Important to bring about Economic Development?

From the discussion of the linkages which exist in the Pharmaceutical Industry above, it would seem that there are numerous prospects for the big and the small and micro enterprises (SME's) to effectively establish formal linkages, for the development of the survivalist sector. Whilst the linkages look separate, they can be brought under one to include the growing of herbs and traditional plants, and exporting these to Europe and USA and or selling them to the local pharmaceutical companies.

From the problems given by the various companies in the industry, it seems that it might be

better to focus on the export market with some limited beneficiation. The main reason for this is that the Medical Control Council is very uncomfortable and gives unnecessary headaches to companies manufacturing traditional medicines. The most common problem three of them gave involved the use of names that describe how the Africans believe the medicine to work. For example, the case of blood mixture (*Sarsasaparilla)*, which is a strong laxative believed to cleanse blood and the system, is a typical controversy with the Medical Control Council. They maintain that the name is potentially deceptive as it might lead the non Africans to believe that the medicine cleans the blood while it is only a laxative. Therefore, the council holds that the medicine should only be described as a laxative. This position is held for all the other traditional medicines. There would be no problem if the company said what the medicine is, without using claims as names of the products.

The company complied at one time by calling the medicine a laxative but lost sales as the users saw it as a different product which would not cleanse their blood and system. The company reverted back to the original name but has had to constantly ward off threats from the Council. To avoid this problem, most companies have chosen the unregistered route and here the Council can not touch them directly. Another similar case is that of *Bangalala* Mixture. This mixture is believed to make a man as strong as a bull sexually. The *Bangalala* root is the main ingredient in this mixture but one production manager of a company confessed that the Bangalala root is extinct and cannot be found on the market. In fact, their a *Bangalala* mixture has vitamins as the main ingredients. This revelation was interesting because the *Bangalala* root is common on the open market at Russell Street in Durban and the other pharmaceutical company in fact told us that they use the root in their mixture. Whether there is deception here is something for the MCC to constantly monitor.

The other problem is the proliferation of similar non registered medicines. The difference between the various love , luck and cleansing products is very minimal among the various manufacturers in the Industry. The problem is that to register a medicine, clinical trials are necessary; and these cost about R200,000. In addition to this, the registration of the medicine costs about R20,000. The first problem is that the amounts are prohibitive. Furthermore, to conduct double blind tests for traditional medicines for registration is very difficult as the approach is not to attack a disease but to cure a "person" as a whole individual. This is believed to be so because herbs usually have a number of active ingredients which cure many ailments as opposed to an extracted "aspirin", for example, which only targets a headache or a pain (apparently, once aspirin is extracted the rest of the ingredients are thrown away and this is the main departure from the alternative medicines).

Once the Medical Control Council facilitates the opportunities for companies to deeply enter the traditional medicines sector, it would be easy to realise linkages which would bring about development in the industry.

4. Institutional Arrangements Needed for Good Linkages.

For the linkages mentioned above to bring about development, it would be necessary to have a marketing system which distributes benefits to all members of the supply chain. The envisaged institutions and their relationships would be as follows: Firstly, it will be important for the

traditional gatherers of herbs to organise themselves. The growers would then be taught how to cultivate traditional plants and herbs, and also the best methods of harvesting and immediate storage. This kind of assistance could come from Pharma Natura who already have experience in this area.

The second important institution are the middle men like Kirch who would make arrangements to buy these harvested plants and herbs and sell them to the pharmaceuticals who produce traditional medicines. The use of middlemen would be very useful as these companies would know the raw material availability and match this with the demand from the manufacturers. The middle men could also pass information back to the growers or gatherers as to what is in demand, how it can be cultivated to increase the supply, etc. The present practice of driving truck loads of plants and herbs from as far as KwaZulu Natal and expecting to find a willing buyer in Johannesburg is rather inefficient.

Once the traditional medicines and registered medicines have been manufactured in whatever form, it will be important for these to find their way to the 750,000 herbalists in the country and the final consumers by using extensive traditional and non traditional channels of distribution. It was mentioned that these retail outlets should be required to employ recognised herbalists from the Herbalist Association in the same way pharmacists are required in the pharmacies. Vertical integration as currently practised by GM Pharmaceuticals by running an adult gift shop next to the factory where the *high rise*, *amandla enkunzi*, *power up, super Bangalala* to mention a few, are sold along side the other adult gifts, seems to be another root to improve distribution.

Thirdly, Pharma Natura and Kirch would also be very useful export agents who would add value to the plants and herbs through grading, packaging and processing, as well as increasing the total demand for them, before they are exported to Europe and USA.

Above all, the Medical Control Council should actively involve the Herbalists Association in their efforts at advising the government in amending the existing Acts governing the operations in the industry. It would also be very important for the Council to police the industry in such a way as to facilitate operations so that the final consumers are protected and not to seem to be protecting the big pharmaceutical companies.

C. Linkages in the Durban and Richards Bay areas

Preliminary Report - Durban and Richards Bay

1. **Entities Surveyed**

A total of 10 interviews with corporates and 2 with SMMEs had been conducted as at 30 January 1998. A comprehensive listing is attached.

2. **Preliminary Findings**

2.1 Corporates

Some key aspects of the data analyzed thus far shows the following:

a. Corporate's Primary Rationale for Entering into Linkage Activities

	Ranked 1	Ranked 2	Ranked 3
Support Black enterprise upliftment/empowerment	5	1	2
Search for efficient and/or low-cost suppliers	2	2	3
Outsource peripheral activities and concentrate on core business	0	5	2
Mandated because of Affirmative Action	1	1	1

b. Sourcing Policies

All companies have competitive buying policies, with quality and price issues prevailing. End user influence and involvement in the buying process (where relevant) tends to be high.

c. Type of Linkage Activity

The emphasis is strongly biased towards non-core; service based linkage activities and is likely to remain so for the foreseeable future. All corporates indicated that they draw a distinction between core and non-core activities in their business and would never consider outsourcing core activities.

Most corporates interviewed thus far, have a high degree of investment in technology and or capital investment in relation to their core business. Concomitant with this is a high degree of management expertise. This factor probably precludes outsourcing of core business in companies of this type, given the shortage of skills which exist in South Africa. Even for non-core activities one company highlighted the difficulty a SMME would encounter in establishing an operation relevant for their situation. Using the example of injection moulding, which they want to outsource, the capital expenditure for one machine could amount to R1.4 million.

However, the one example which could be argued is an outsourcing of a component of a core activity, is Tongaat-Hulett's sugar agricultural division's sales of sugar estates to medium scale farmers. The distinction here appears to relate to the level of technology required by the farmer.

d. Written Policy on Linkages

Only one company had a written explicit policy on linkages, but what was encouraging to note was that four are currently drafting one. This indicates a growing commitment to the process and they expressed the hope that it would lend focus to senior management and buyers.

e. Impediments to Expansion and Improvement of Linkages

(i) Supplier (SMME)

	Ranked 1	Ranked 2	Ranked 3
Technology	3	0	0
Quality	1	2	2
Delivery	3	2	1
Price	1	2	2
Access to Finance	2	0	0

Clearly, delivery problems appear to be the largest impediment. Given the profile of the corporates surveyed it is not surprising that technology had such a high weighting.

(ii) Buyer (Corporate)

	Ranked 1	Ranked 2	Ranked 3
Top Mgt Commitment	1	2	1
Buyers	2	1	1
User Resistance	1	0	0

At least four companies indicated a lack of top management commitment and buyer resistance to linkages. On the latter, some companies felt that the matter should be put into context. Simply put, buyers are judged on their buying performance. As indicated earlier, user influence tends to be high and buyers are conscious of this. Hence are nervous to make a buying error, even for low risk purchases.

One company also indicated that they would not change suppliers for the sake of establishing a linkage with a historically disadvantaged firm. Relationships are sometimes built up over a long period of time which are not easily broken and if contracts are substantial then the effect of terminating business may in turn negatively impact on that supplier's employment levels. Hence, their philosophy is to try to develop linkages where new business opportunities arise or where volumes have increased.

(iii) Other Impediments

Most companies surveyed tended to be neutral about intermediary and training agencies. On the former, some expressed the opinion that they did not market themselves enough and suggested that they could sell business services to corporates (such as market research for example).

Trade unions enjoyed a mixed response. Some saw them as a major impediment, others as no impediment at all. The distinction appeared to come in where there had been outsourcing to former employees. Where this had not occurred, or where linkages occurred in the context of traditional external sourcing arrangements, unions had proved to be no impediment at all.

2.2 SMMEs

As only two SMMEs had been interviewed at the time of drafting this report, it would be far too premature to draw any definitive observations. However, in the researcher's opinion, both SMMEs can be classified as success stories in the context of linkage activities. Both owner-managers display typical entrepreneurial characteristics, come from strong management backgrounds, have appropriate technical qualifications and experience and relate examples where the corporates they link with have assisted them at one time or another. Both enterprises are also now consistently winning open competitive tenders, which implies that for the corporate they are achieving their objective of sourcing from an efficient supplier.

3. Some Overall Observations

A number of companies commented on the paucity of historically disadvantaged SMMEs who had the scale and capacity to enter into linkage arrangements with big companies. One company cited an instance where they had literally scoured the major cities of South Africa for a black component manufacturer and were not able to find a single one of any sophistication whatsoever. If this is a typical situation, then what can be done to develop linkages?

Some observations, which emerged from discussions with all entities interviewed, were as follows: -

- "Sweat Equity"

  A number of corporates interviewed were of the opinion that to entering into developing effective linkage arrangements takes resources, most particularly time and skill which normal buyers do not necessarily have. It is also likely to be a painful process at times, so the resources must be committed fully to the process.

- "The goaler can't be the advocate of the prisoner"

  Consequently, a specific manager, preferably black, should be appointed to drive the process in a pro-active, rather than passive manner. Where this has occurred, companies tend to be far more active in developing linkages with historically disadvantaged SMMEs.

- "With a Direct Line to the CEO"

  One company has established such a reporting structure, whereby the 'Business Development Specialist' reports concurrently to the Chief Buyer and CEO. The latter ensures that there is real commitment to the process.

- "What gets measured gets done"

  Linkage activities should be measured and reported to senior management.

- "Everyone should come to the Party"

  Both SMMEs interviewed were of the opinion that corporates had sufficient resources to devote serious consideration to developing linkages.

  One company interviewed expressed intense frustration at what was perceived to be the unwillingness of financial institutions to provide meaningful finance for SMMEs.

  The SMMEs felt that government was dragging its feet in many areas pertaining to small business development.

- "Nobody has the recipe for success ..... just yet"

  A regional initiative is being developed in the Richards Bay/Empangeni area, which will enable the Chief Procurement Officers of all the major corporates to meet once a month, exchange ideas on linkages and network.

- "Its going to take time"

  One company felt that apartheid had left such a legacy of economic and skills disempowerment, meaningful linkages will take a long time to develop. This was contrasted with the Far East where there was an infrastructure in place which facilitated the development of linkages.

- "Black Business Should Instigate More"

  One manager felt that black business groupings should take the initiative in developing mechanisms to facilitate linkages, even if it meant organizing a forum and sitting "eyeball to eyeball with 'white' business" on this.

- "We Need a Growing Economy"

  Without this, linkage activity is unlikely to get the kick-start it so desperately needs.

One Senior Executive interviewed suggested the following to make the system work better, to enable more linkages to get started or to enable existing ones to improve or expand:

- Companies must have clear policies on this
- Make resources available
- Have a spirit of learning
- Handle with kid gloves to facilitate
- Have heart without compromising
- Provide training
- Never be paternalistic

ENTITIES INTERVIEWED

Corporate	Activity/Sector	Interviewed	Linkage Policy	Backward Linkage Activity	Impediments	Future Emphasis
T&N Holdings Ltd (Durban)	Automotive Products (3 600 employees)	HR Executive	Informal (Not written)	Very minimal	Technology	Forward linkages Franchise arrangements Backward Linkages Non-core Service
Richards Bay Minerals (Richards Bay)	Mining (2 112 employees)	Buyer	Written	Active and Increasing	Technology SMME's Access to finance Buyer Resistance	Non-core service
Alusaf – Bayside Smelter (Richards Bay)	Primary Aluminium Reduction (1 470 employees)	Manager Materials	Presently drafting a written policy	Minimal but likely to increase	Unreliable Delivery Quality Price	Non-core service
Alusaf – Hillside Smelter (Richards Bay)	Primary Aluminium Reduction (1 250 employees)	Manager Materials	Presently drafting a written policy	Increasing	Technology Quality Delivery SMME's Access to finance	Non-core service Consumable Items
Tongaat-Hulett Group Limited (Tongaat)	Diversified Company Food, Industrial, Property (22 000 employees)	Director	Not specifically relating to linkages. Part of overall policy of Black Economic Empowerment (which is written)	Not applicable at Group Level	Price Delivery Quality	Will explore any possibility within context of group policy. Extent depends upon definition of core and scope of arrangement
Tongaat-Hulett Sugar Limited (Tongaat)	Sugar production and milling	HR Manager Agric	Part of group policy	Active (Medium Scale Farms)	Unions HIV	Will continue on Non Strategic Viable Farming Lands
Tongaat-Hulett Sugar Limited (Durban)	Refinery (863 employees)	HR Manager	Part of group policy	Active but static	Delivery Price Quality	Non-core service
GoGos Baketime (Pty) Ltd (Durban)	Bakery, Fast Food Franchise operation for black entrepreneurs	Chairman	Not relevant in context of their operation	Not relevant in context of their operation	Access to finance Management Skills	Seek additional partners with management skills
SAPREF (Durban)	Crude Oil Refineries (670 employees)	HR Manager Contracts & Office Services Manager	Presently drafting a written policy	Minimal but likely to increase	Delivery Price End user resistance	Non-core service May consider engineering
Toyota SA Manufacturing (Durban)	Motor Manufacturer (7 295 employees)	Purchasing Manager – Small Business Dev	Presently drafting a written policy	Active but static	Quality Delivery Price	Non-core service Possible JVs

SMME	Activity/Sector	Interviewed	Linkages With	Sales % to Big Buyers	Impediments	Benefits of Linkages
Zonke Engineering CC (Richards Bay)	Mechanical, Pipe Fabrication and Installation Started 1996 (25 employees)	Managing Member	Richard Bay Minerals Alusaf Hillside	100%	Technology Top mgt commitment	Growth of business
Maziyas Engineering Services (Durban)	Mechanical and Piping Contractors Started 1994 (35 employees)	Managing Member	Genrec Grinaker Petronet WK Construction	100%	Quality Top mgt commitment Buyer resistance Lack of govt incentives	Growth of business

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D. PROMOTING THE GROWTH OF MICRO AND SMALL ENTERPRISES IN THE NORTHERN PROVINCE

1. INTRODUCTION

Promoting the growth of micro and small enterprises (MSEs) is one of the ways to alleviate poverty in developing countries. MSEs are effective instruments for generating income and for reducing unemployment. In the Northern Province -- the poorest province and characterized by a high rate of unemployment -- MSEs can play a major role in improving the well-being of the poor.

One way to promote the growth of MSEs is to establish linkages (where they do not exist) or strengthen existing linkages between suppliers and buyers. Development institutions such as the Agricultural and Rural Development Corporation (ARDC) and Northern Province Development Corporation (NPDC) can play a major role in establishing or strengthening business linkages.

The ARDC is a parastatal serving as the development arm of the Department of Agriculture, Land and Environment in the Northern Province. The corporation was established in 1996 when three former homeland corporations were amalgamated. The ARDC's head office is located in Thohoyandou. Regional offices are located in Thohoyandou, Lebowakgomo and Giyani. Although the corporation itself is young, the three former homeland corporations had been in operation for decades. Thus, there is a wealth of experience within the corporation which can be tapped on to promote the growth of MSEs in the Northern Province. The mandate of the ARDC is to promote agricultural and rural development in the Northern Province. Thus, the ARDC's mandate extends beyond the agricultural sector. In addition to managing its own agricultural projects and agribusinesses, the ARDC also manages agricultural projects on behalf of the Northern Province Department of Agriculture, Land and Environment.

The formation of the NPDC was the initiative of the Northern Province Government as per the Corporation's Act Number 5 of 1994, effective 1 July 1996. The NPDC is an amalgamation of the Development Corporations which existed within the former homelands of Gazankulu, Lebowa and Venda. Although the objectives of the entities were similar, various developmental approaches and governance structures evolved in each of the former Development Corporations which existed in terms of the focus that resulted from the strategies that were pursued. The main objective of the NPDC, in terms of the Act, is to, either directly or indirectly, promote and carry out the economic development of the Northern Province and its population in the commercial, financial and industrial fields, mining, public transport, tourism, training, housing and community development, and to provide for matters incidental thereto. In a partial unbundling of the Corporation, a separate ARDC was established. The responsibility for development in the remaining economic sectors throughout the Northern Province vested with the ARDC.

The NPDC is a parastatal serving as the development arm of the Department of Economic Affairs, Trade and Industry. The NPDC is headquartered at Lebowakgomo and has three regional offices. The NPDC is actively involved in promoting the growth of MSEs and has a division responsible for providing services to MSEs.

2. OBJECTIVES OF THE STUDY

The overall objective of the study is to determine the contribution which the ARDC and NPDC can make to the growth of MSEs in the Northern Province. The specific objectives are to:

(a) describe business activities of ARDC and NPDC related to MSEs -- what are these corporations doing to promote the growth of MSEs?
(b) identify businesses previously owned by ARDC and NPDC and sold or transferred to private companies and/or individuals;
(c) establish whether ARDC and NPDC play any role to ensure that businesses previously owned by these corporations maintain or strengthen business linkages established prior to change of ownership;
(d) propose the most appropriate way(s) in which the ARDC and NPDC can link small and large businesses and ensure that the linkages are sustainable;
(e) describe buying and selling activities of ARDC and NPDC and determine how the two corporations can use their expertise in these activities to promote business linkages (between small and large businesses)

3. DATA COLLECTION

Data were obtained from interviews with business enterpreneurs (buyers and suppliers) associated with the ARDC or NPDC or businesses previously owned by these corporations. Information was also be obtained from available documents at the two corporations and businesses included in the survey. The sample included 33 buyers and 30 suppliers. Buyers included both large and small businesses who buy from small businesses. Suppliers included small and large businesses who sell to large businesses. The sample included businesses in the vicinity of Pietersburg; namely: Pietersburg, Seshego I, Seshego II, Lebowakgomo, Portgietesrus, and Mahwelereng.

Both primary and secondary sources were used to collect information on the activities of ARDC and NPDC. Interviews with officials of the two corporations were conducted to get an insight into the business activities of the corporations. In addition, existing documents describing the activities of the two corporations were examined.

A list of businesses previously owned by ARDC and NPDC, and transferred or sold were obtained from the two corporations. Businesses previously owned by ARDC or NPDC were requested to provide names of buyers they do businesses with. The lists of names of businesses were used to select the sample of businesses to be interviewed. The businesses included in the sample were selected so as to represent a broad spectrum of business activities (sectors) and geographic regions.

ARDC and NPDC officials were requested to indicate the role which the two corporations play in maintaining or strengthening linkages between businesses they previously owned and other businesses. Businesses previously owned by ARDC or NPDC were also requested to explain the role played by the two corporations to assist them to maintain or strengthen linkages with other businesses.

4. RESULTS

The distribution of cases in the study areas is shown in Table 1. Lebowakgomo, Mahwelereng and Seshego I & II are former Black townships whiles Portgietersrus and Prietersburg are former Whites towns. Most of the buyers interviewed came from Lebowakgomo and suppliers mostly from Mahwelereng. More big buyers and suppliers will be interviewed later from other former white towns in the Northern Province.

Tables 2 and 3 indicate the general information on buyers and suppliers in the areas covered so far. The results show a diverse range of core activities of the buyers and suppliers. Respondents were relectant to reveal any information on financial position of the business. As a result, figures on capital investment, volume of sales per year and gross income per year were not available.

Out of the 33 buyers interviewed the number of employees ranged between 2 and 88. Businesses operating on larger scales than these will be interviewed later. A fairly large number of workers appeared to be unionized and COSATU affiliated. Out of 24 respondents, about 44% indicated that they were unionized, and out of 23 respondents 65% indicated that they were affilited to COSATU. In general the purchasing staff of buyers interviewed were mostly Blacks. This is an indication of buyers offering job opportunities for Blacks in the province. The preliminary results so far indicate that 96% out of 25 respondents from buyers have linkages with small suppliers but only 33% out of 6 respondents were willing to give the names of the suppliers (Table 4). Out of 21 respondents the average duration of linkages was about 3 years. An indication that most of them have been in linkages for a short period. Linkages seem to be mostly between small buyers and small suppliers. Most buyers interviewed operated on small scales, as indicated by the small number of employees and the estimate of capital investment from two respondents.

Information on personal background of the business operators/ownesr/managers indicates that most of the suppliers were males aged between 27 and 66 years. Out of 30 respondents 67% were males with an average of about 44 years (Table 5.1). Most of them were married (87%) with an average of three children per family. Only 33% indicated that they reached tertiary education level. Out of 26 respondents interviewed, all (100%) indicated that they had had some form of formal management training, and were employed before starting the business. Out of 25 respondents, 56% indicated that they had worked for someone else in the same line of business. Among 30 suppliers interviewed the number of workers ranged between one and 43, and indicated that only about 36% of their total sales goes to big buyers (Table 5.2). This result emphasises the existing poor linkages between suppliers and buyers. In all, 63% operated as sole proprietors, and about 53% of these suppliers sold to few buyers ranging between two and three. The number of workers unonized among suppliers appeared to be samller compared to buyers. Out of 30 respondents only 20% indicated that they were unionized.

The role played by ARDC and NPDC to promote linkages is yet to be established.

Table 1: Distribution of cases in study areas

Area	Suppliers		Buyers		Total	
	cases	%	Cases	%	Cases	%
Lebowakgomo	03	10,0	15	45,5	18	28,5
Portgietersrus	00	00,0	10	30,3	10	15,9
Mahwelereng	10	33,3	00	00,0	10	15,9
Seshego I & II	09	30,0	00	00,0	09	14,3
Pietersburg	08	26,7	08	24,2	16	25,4
	30	100,0	33	100,0	63	100,0

E. OVERVIEW OF FINDINGS TO DATE

1. There is widespread interest in linkages; many corporates are talking about them, a number have a board-room commitment to expand them, there are several programs of one kind or another to push them. The government is emphasizing the need for businesses to contribute both to employment and to the growth of small enterprises. Many feel that the most effective way to do that may be through linkages.

2. From a developmental point of view, not all linkages are equally good. Some are undertaken primarily as a social responsibility activity, in which case they often have very little developmental impact. In fact, they can be anti-developmental (e.g. if they reflect primarily attempts to escape from labor standards, taxes or production in accordance with government regulations).

3. Linkages can contribute to the development of supplier enterprise in three ways: i) through the provision of markets; ii) by providing information about products or services for which there is a market; and iii) by providing training/advice/guidance to help suppliers increase their capacity to be reliable partners to meet those markets. The following discussion looks at each of those three categories, since the developmental contribution of the linkage is determined primarily by the degree to which each works well.

4. On **markets**, the basic point is simple; the most serious problem facing most small enterprises is finding markets. If someone comes to a small producer and offers to buy her output, that's heaven. The level of heaven achieved is determined by three factors: a) the size of the purchases; b) the regularity of the purchase; and c) the time period of the contract.

On size, for the supplier, the bigger the better (so long as it doesn't surpass her capacity to supply it, in which case, the contract would need to be broken into pieces). From a buyer's perspective, many corporates are recognizing that dealing with lots of suppliers is costly; they are trying to cut down on the total number of suppliers they buy from. At the same time, they are committed to opening up the field to historically disadvantaged suppliers. But how many? And how much from each one? One buyer said: we don't want any supplier to become too dependent on us, so we look for a number of qualified suppliers, then divide our purchases among them all, trying to make sure that each receives enough orders to keep going. That seems like a recipe for keeping them small, of providing a little assistance but not enough to help a small enterprise grow enough to achieve real efficiency. Good business would suggest: buy from as few as you can and still get competition and efficiency. This means that the goal is not to buy from as many as possible, but to open the door to new suppliers, buy as much as they can supply, help them get big. Smallness by itself is not a necessary feature of participation in the process.

On the regularity of purchases, there has been a temptation for large corporates to use outsourcing as a way of coping with irregular markets. When that happens, any variations in demand fall in a magnified way on the suppliers.

Related to this is the issue of length of contract. Buyers are tempted to try to keep the contracts short, partly to protect themselves from variations in their need, partly as a way of maintaining a dominant position viz-a-viz suppliers. But for suppliers, longer-term contracts have two great advantages: they allow for better management associated with a longer term planning perspective; and they make it possible to think about capital investments (e.g machinery or equipment) that would make sense if one had a three-year contract, but not if one had to operate on the basis of twelve successive three-month contracts. Financial institutions may be much more willing to lend to borrowers with such longer-term contracts.

Linkage contracts cannot change the underlying uncertainties or irregularities in final markets. The essential point is that, to the extent that buyers seek to push those risks off onto suppliers, this decreases the likelihood that the linkage contract will enable the supplier to improve in efficiency. Conversely, to the extent that the buyer is able and willing to share these risks with the supplier by providing larger, longer-term and more stable contracts, the suppliers who benefit will be better able to improve their capacity to provide a more reliable, higher quality and lower cost supply of products or services. **It is in the buyer's business interest that their suppliers be able to make these improvements.**

5. On information about new markets, the main point is that nobody knows these markets as well as the buyer. This is the person (or institution) most likely to be in touch with the final markets, able to see opportunities and interpret requirements back through the value chain if these markets are to be served. What is needed is a mechanism so that information can flow back to actual or potential suppliers, to help the latter adapt their products or services to evolving market needs.

Some have approached this question in terms of a data base, listing buyers of particular products or services and actual or potential suppliers from whom these buyers might purchase their inputs. The experience with this approach is generally quite disappointing. The information is not easy to collect and manage in a form that is useful to participants. It quickly goes out of date, due to enterprises moving or closing or changing activities. The search for comprehensiveness ("so all have an equal chance at new opportunities") may be a costly chimera.

Two points appear to emerge from the interviews here.

i) While the goal of opening up new opportunities to serve new markets by enterprises that were previously excluded is laudable and desirable, that does not necessarily mean that linkage promotion agencies need to exert major efforts to achieve comprehensiveness in their coverage. A more reasonable approach might involve making the facility known through low-cost media approaches, then concentrating on working with those that come forward.

ii) In terms of the transfer of knowledge about evolving markets and the products needed to serve them, there is no substitute for direct interactions between buyers, who are in direct and commercial contact with these markets, and suppliers, who may help them through participation at earlier stages in the value chain to supply those markets.

6. On the question of training, counseling and other forms of skill upgrading, the key questions are who is in the best position to provide this function? How should it be organized and paid for? If business linkages are to play their full role as development mechanisms, these are crucial questions, since an important part of the benefits claimed for linkages come precisely from the opportunities they provide for this type of improvement in skills, in management, and generally in the efficiency of the suppliers.

In South Africa, there are three principal groups of institutions engaged in supplying these functions: the Local Business Service Centers (LBSC); specialized training organizations (often NGOs); and the buyers themselves (a process sometimes called "buyer-mentoring"). Experience in other countries suggests that this function is done best (and most cost-effectively) when it is done by the buyer. Specialized training programs can play an important role here, if they are sufficiently capable and sufficiently focused. The least effective arrangement has generally been to combine these with the broader responsibilities of generalized business promotion agencies. It is too soon in our research to reach any clear judgements on these options in South Africa. What does come out in many of the interviews is that most of the buyers have played only a minimal role in mentoring their suppliers. Of course there are exceptions, but most appear to view their linkage activities primarily as a form of community service. Starting from this perspective, only few of them appear to have decided that, if they invest time, energy, and perhaps some funds in their suppliers, the results may be a lower cost, higher quality and more reliable supply of inputs or services. Until that becomes a central part of their vision, linkages will be able to make only a limited contribution to the development of the country.

Project EAGER/PAGE
Equity and Growth through Economic Research in Africa
Public Sector for Growth with Equity

The Development of Capital Markets and Growth in Sub-Saharan Africa.

Research Proposal Final Design

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Presented at the USAID EAGER Workshop, Johannesburg, South Africa
February 4 - 6, 1998

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Abbreviations

ANOVA	Analysis of variance
SSA	Sub–Sahara Africa
BOT	Bank of Tanzania
BOG	Bank of Ghana
RSC	Research Supervision Committee
GSE	Ghana Stock Exchange
OAU	Organization of Africa Unity
NBFI	Non–banking Financial Institution
SME	small and medium enterprises
IMF	International Monetary Fund
EAGER	Equity and growth through Economic Research
PAGE	Public Sector Growth and Equity
SSNIT	Social Security and National Insurance Trust
CMO	Collaterized mortgage obligation
OLS	Ordinary least squares
TSLS	Two Stage Least Squares
ESRF	Economic Social Research Foundation
CEPA	Center for Policy Analysis
MOFA	Ministry of Finance
NBC	National Bank of Commerce
UDSM	University of Dar es Salaam
CMSA	Capital Markets and Securities Authority
FINSAP	Financial Institutions Sector Adjustment Program
GDP	Gross domestic product

Abstract

A major constraint to growth and development in Sub-Saharan Africa (SSA) is the lack of long-term capital for investment in the private sector. This problem is due to the lack of developed capital markets (stocks/bond exchanges, venture capital funds, mutual funds, and unit trusts) and the non-banking financial institutions that intermediate in the capital market.

The underdevelopment of the capital markets in Africa has been traced to various macroeconomic policies, governance, institutional, and structural impediments that constrain the development of the capital markets. Financial sector reforms in SSA focused on commercial banks that dominate the financial markets in Africa. This focus on the banking sector has led to the neglect of the non-banking financial institutions that intermediate in the capital markets, Jefferis (1995), and Popiel (1990). However, even though the financial sector reform in SSA was aimed at efficient allocation of credit to the private sector, the liberalization of the financial markets has led to banks exercising their prudent investment options of holding a greater proportion of their assets in riskless short-term government securities. As a result, credit to the private sector in many SSA's has declined considerably.

Thus, many policy makers and government officials began to emphasize the development of long-term capital markets for capital mobilization and allocation to the productive sectors of the economy. The importance of this was underscored by the convening of the African Capital Market Forum in Accra, Ghana in June 1996. The objective is to explore various ways of developing efficient capital markets in Africa in order to mobilize long-term capital for private sector development and growth. The above sentiment was also echoed at the Abuja Summit of OAU Heads of State convened in 1991. At that meeting, there was a declaration that each country should be encouraged to set up a stock exchange to mobilize long-term capital towards the establishment of a proposed African Economic Community. In addition, the 1997 Conference of the Council of African Ministers of Finance that met in Addis Ababa had an extensive discussion on the need and ways for capital market development in Africa and called for speedy progress in its formal Addis Ababa declaration.

The development of well-functioning capital markets is vital for growth and poverty alleviation in SSA. Efficient capital markets provide greater mobilization of domestic capital, improve efficiency of allocation of credit to the private sector, provide risk diversification by investors, lower the cost of equity capital, and raise the supply of long-term capital for investment and growth. Developed capital markets also provide a wider menu of financing capital sources by corporations that may raise long-term capital through the issue of equity, bonds, and other investment instruments. Well functioning capital markets also mobilize international capital in the form of foreign portfolio investment by foreign investors.

At a recent interview in Lusaka, Zambia, the Minister of Finance, Mr. Ronald Penza lamented that the SSA countries are the only countries that will be entering the twenty first century poorer than at the time of their political independence. The main premise of this research proposal is that the scarcity of long-term capital in SSA is a major constraint to the development of the private sector and growth. The development of efficient capital markets will serve as the bridge to the 21st. century private sector development, growth, and poverty alleviation in SSA.

A. The Statement of topic and its importance

A.1. The Statement of the problem

In the 1980s as part of their structural adjustment programs, many Sub–Sahara African (SSA) countries embarked on comprehensive financial sector reforms in order to mobilize financial resources for investment and growth. The financial sector reform had as its primary objective the enhancement of the soundness of the banking institutions in order to improve deposit mobilization and credit allocation to the private sector for investment and growth. However, recent studies have shown that the financial sector reform did not make adequate provisions for the development of the capital markets in the Sub–Saharan African countries (World Bank, 1994, 1990, De Melo and Tybout 1986.)

In 1990, the World Bank initiated a study to identify constraints to private sector development and growth in selected Sub–Saharan Africa.[1] The study concludes that the most severe constraints on the private sector development in Sub–Saharan Africa is the scarcity of credit allocation to the private sector (World Bank 1990). The above finding was corroborated in separate studies by Steel et al. (1991), Marsden et al. (1987), Aryeetey (1994), Levy, (1993), USAID Project No. 940–2028.03 (1991), and Levitsky (1990). Marsden and others conclude that the private sector development is hampered by the shortage of investment funds and working capital, especially for small and medium enterprises (SMEs) throughout Africa.

It is argued that the focus on the commercial banks has led to the neglect of the non–banking financial institutions (NBFI) that have comparative advantage in mobilizing long–term capital for investment. Those critics argue that commercial banks are not well structured to meet the long–term capital needs of the private sector for several reasons. First, commercial banks' assets and liabilities are of short–term nature, and as such, they are incapable of providing a greater supply of long–term capital to the private sector. Secondly, higher yields on short–term government Treasury bills provide greater incentives for commercial banks to hold a larger proportion of their asset portfolios in short–term government bills. This action has led to the crowding out of private enterprises, especially small and medium–sized enterprises (SMEs) from the credit market. Thirdly, government regulation in terms of reserve requirements and the new risk–based capital requirements constrain the ability of commercial banks to provide long–term capital to the private sector. Fourth, commercial banks face real challenges of assessing the risks of borrowers properly in an informationally imperfect environment and would be averse against extending credit for business activities that are considered very risky.

Furthermore, commercial banks face the problem of enforcement of contracts and the recovery of debt from borrowers. Thus, the reluctance of the commercial banks to extend credit to the private sector may be a rational decision to minimize their risk of default on loans. Also,

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[1]Samuel, Paul. Assessment of the private sector: A Case Study and Its Methodological Implications, World Bank Discussion Papers, No. 93, Washington, DC (1990), p. iv

recent studies by the World Bank (1997) and Aryeetey (1995, 1994, 1992a, 1992b) conclude that the informal sector is incapable of providing long-term capital for the private sector because of its segmentation and bias for short-term credit.

It has been recognized that capital market development will play a crucial role in the development efforts of African countries. This importance is underscored by the convening of the African Capital Market Forum in Accra, Ghana in June 1996 to explore various ways of developing efficient capital markets in Africa in order to mobilize long-term capital for private sector development and growth. Various heads of states attended this meeting from Africa and other dignitaries from international organizations, and donor countries.[2] The above sentiment was also echoed at the Abuja Summit of OAU Heads of States convened in 1991. At that meeting there was a declaration that each country should be encouraged to set up a stock exchange to mobilize long-term capital towards the establishment of a proposed African Economic Community. More recently, the 1997 Conference of Council of African Ministers of Finance passed a unanimous declaration on the need for speedy development of capital markets and privatization of state-owned enterprises through capital markets.

In his study, Cho (1986) concludes that a well-functioning capital market is vital for enhancing the allocative efficiency of channeling credit to the productive sectors of the economy. Capital markets provide the avenue for mobilizing domestic financial resources in the form of individual investors investing in stocks, bonds, mutual funds, and other forms of investment portfolios. Corporations can raise long-term capital by issuing equity shares and fixed income securities (bonds). Capital markets also lead to risk diversification whereby individuals may hold portfolio investments in various corporate stocks and bonds. In addition, capital markets provide the avenue for commercial banks to raise needed liquidity by the securitization of their long-term loans and other collateralized mortgage obligations (CMO). This will increase the ability of commercial banks to augment credit to the private sector.

Privatization of state-owned enterprises is considered as key to the future development and growth of the economies of African countries. However, the privatization efforts have been constrained by the shortage of capital in the private sector. This is a direct result of the underdevelopment of capital markets in SSA. Thus, a well-functioning capital market would raise needed capital for the purchase of state-owned enterprises, the start of new enterprises, and the expansion of existing companies.

Furthermore, the end of the cold war, the globalization of business activities, political, and financial sector reform in many developing countries have led to the attraction of foreign portfolio investment in the emerging capital markets of the developing countries. Between 1989 and 1995, the flow of foreign equity capital to the developing countries increased from $3.5 billion to $120 billion (World Bank, 1996). However, only one percent went to Sub-Saharan Africa.

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[2]The Co-Pi, Dr. Senbet is a member of the Interim Governing Council of the forum and its Program Committee and Dr. Sam Mensah, the co-investigator on this study is the Secretary of the Interim Council.

It is suggested that various institutional, policy, and structural factors impede the growth of the capital markets in SSA. The lack of good governance, political instability, and imprudent government regulations inhibit the growth of the capital markets. Financial repression and macroeconomic instability of high inflation and the depreciating value of the local currencies has caused the loss of confidence in the formal financial institutions by individual savers and investors.

Furthermore, the inefficiency of information and the lack of data on capital markets in SSA make it impossible for investors to assess the risk of the stocks of the underlying companies for rational investment decision making. It has also been suggested that the underdevelopment of the general economy, the poor performance of underlying companies, and the narrow selection of stocks and other financial instruments affect the capital markets of the African countries. It is alleged that the small size of the national economies of the African countries could not sustain viable capital markets (stock and bond exchanges) in each individual sovereign nation. However, others argue that the converse may also be true. There is evidence by a World Bank study that the underdevelopment of the capital markets impede the development of the national economies of the SSA. Thus, because of the small size of African economies, government officials and policy makers have began serious consideration of regional and global integration of the individual capital markets to attract foreign capital inflows. This consideration has been underscored by the recent initiative in 1997 to set up the Abidjan Stock Exchange as a regional anchor for the Franchophone West African countries within the West African Economic and Monetary Union (WAEMU).

The good news is that there are eleven stock exchanges in Sub–Saharan Africa, including Ghana, Botswana, Ivory Coast, Nigeria, Zimbabwe, Kenya, Swaziland, Zambia, South Africa, and a few other countries. Indeed, these markets have begun receiving the attention of Wall Street and European investors as depicted by the establishment of over fifteen Africa funds now trading in New York and Europe. This is remarkable, given that there were none investing in SSA (except South Africa) by 1992. The bad news is that these markets have displayed extreme thinness and lack of liquidity. With the exception of South Africa, the stock markets in Africa are the smallest and the least developed in the world when measured by listing size and capitalization. For example, there are only four companies listed on the Swaziland stock exchange in 1995, five on the Lusaka stock exchange in Zambia, 12 in Botswana, 56 in Kenya, 21 in Ghana in 1996, and 181 in Nigeria. This compares with over 7000 listed companies in the U.S. In addition, the performance of some of the above stock exchanges in terms of attracting domestic and foreign investors remains very weak.

A.2. Policy Research Questions

The above discussions raise the following policy research questions: (1) What is the impact of the financial sector reform on the capital market development and the operations of non–banking financial institutions (NBFI) that intermediate in the capital markets? (2) To what extent has the existence of stock exchanges been a source of supply of long–term capital for private corporations in Ghana and other Sub–Saharan African countries? (3) In those countries, for example in Tanzania, where the stock exchange has not been formally opened for trading, what are the sources of supply of long–term credit to the private sector? (4) What are the pre–requisites for establishing

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a stock exchange in Tanzania and other SSA countries? (5) What are the linkages between capital market development and real sector growth in the sample countries? (6) How will the capital markets in the two countries be regionalized or globalized in order to attract foreign portfolio investment?

A.3. The Objective of the Study

The objective of this study is to provide a systematic investigation of the foregoing research questions using Ghana and Tanzania as case studies. Specifically, the study will examine: (1) the structure of the capital markets and NBFIs that intermediate in the capital markets; (2) the various constraints that impede the development of efficient capital markets and how these constraints can be removed; (3) the role of financial sector reform on capital market development; (4) the impact of prudential regulation/supervision on the development of capital markets; (5) the prerequisites of establishing and deepening stock exchanges in the two countries; and (6) the promotion of regional and globalization of capital markets for the attraction of foreign capital inflows.

The study will develop a framework for the analysis of capital market development and empirically test hypotheses based on the research questions that have been raised in the proposal. Empirical tests of the various hypotheses and the results will form the basis for policy formulations and recommendations for the development of efficient capital markets in the two countries.

A.4. Significance of the Study

Many studies have been done to examine the performance of emerging capital markets in the developing countries. However, many of these studies focus on the emerging capital markets of Southeast Asia, Latin America, and the Caribbean. Sub-Sahara African counties have not received the attention that the Southeast Asia and Latin American countries have received in the academic literature. Many of the capital markets in SSA are considered as "basket cases" and therefore were not featured in many studies of emerging stock markets. This study contributes to the research topic by including two countries that expressed their interest and willingness to participate in the second round of the EAGER project.

This study is timely because it addresses many of the important research questions that have been raised by USAID/Washington and other AID missions in Africa, the World Bank, many government officials, and policy makers in SSA. A systematic investigation of the research questions will lead to the formulation of policies towards the development of efficient capital markets in the two countries. In addition, the policy lessons from this study may be applicable to other Sub-Sahara African countries that share similar problems. Also, the research will enhance the private sector development programs of the USAID and the World Bank, currently underway in Ghana and Tanzania.

A.5. How is this study different from others?

There has been a World Bank funded project underway in Ghana to increase the capacity of non-banking financial institutions. Dr. Mensah, the co-investigator on this study, had participated in the background study of that project. The School of Administration at the University of Ghana is also involved with that project which is a consultative project. It involves management training, computerization, and human capacity development at the Ghana Stock Exchange and other non-banking financial institutions (NBFIs.) It is not a research project with policy implications.

A.6. Justification and Applicability to Multiple Countries

This study is concentrated on Ghana and Tanzania for the following reasons: First, the two countries expressed interest in participating in the EAGER round 2 project by responding to the earlier invitation. Secondly, the two countries share a common experience of economic crisis in the 1970s and 1980s due to policy, institutional, and structural rigidities that constrained supply responses. Since Ghana is considered a pioneer in structural adjustment and financial sector reform in SSA, its post-reform experiences and policy implications may provide useful lessons for Tanzania and other SSA countries.

Also, the inclusion of the two countries, which are at different levels of capital market development will provide a useful dichotomy of the relationship between capital market development and real sector growth in the above countries. The inclusion of Tanzania will enrich the findings by providing a pre-stock exchange case of capital market development and the policy implications associated with the development of a stock exchange. Moreover, capital market development, along with private banking development, is in Tanzania's agenda.

B. Background Information on the Need for Capital Markets Development in Ghana and Tanzania

In the 1970s and early 1980s, Ghana and Tanzania embarked on state controls of the economic and political means of developing the economy. However, the repressive tendencies of the two countries led to the deterioration of the economy and the declining living standards of the masses in the two countries[3]. In the early 1980s for Ghana, and mid 1980s for Tanzania, the two countries, in collaboration with the World Bank , the International Monetary Fund (IMF) and other donor countries embarked on a comprehensive structural adjustment program.

[3] For example, Tanzania assumed the distinction of being the fourth poorest country in Sub-Sahara Africa (SSA)

However, there was the realization that the structural adjustment program would not succeed without an efficient financial sector to mobilize financial resources for investment in the private sector. Thus, the two countries embarked on financial sector reform as part of their structural adjustment program. Ghana's financial sector reform known as the financial institutions sector adjustment programs (FINSAP) was launched in 1988 with the assistance from the World Bank, the IMF, and other donor nations.

The main objectives of FINSAP were: (1) to deregulate interest rates and remove ceilings on deposit and lending rates; (2) to privatize government-owned financial institutions and commercial banks; (3) to enhance the soundness of the banking institutions by improving prudential regulation and supervision by the BOG; (4) to improve deposit mobilization and increase efficiency in credit allocation; and (5) to develop the money and securities markets.

In 1991, Tanzania also embraced a comprehensive financial sector reform as part of its structural adjustment program. The objectives of the financial sector reform were: (1) to promote the establishment of private banking to encourage competition in providing banking services; (2) the privatization of state-owned commercial banks in order to improve efficiency and increased savings mobilization; and (3) the liberalization of interest rates and the removal of credit ceilings on sectoral loans and credit.

As a result of this reform, various banks and other non-banking financial institutions were licensed in the two countries during the post-reform period. However, evidence from recent studies shows that the financial sector reform in the two countries did not result in greater allocation of credit to the private sector. In Tanzania and Ghana for example, high yields on Treasury bills has resulted in the crowding out of small and medium-sized enterprises from the credit market. After the reform, banks have begun to exercise their new freedom by reducing lending to sectors considered risky. At the same time, the banks continue to increase their portfolio allocation to the government sector in the form of investment in Treasury bills. In addition, in both countries, many commercial banks with branches in the rural areas have begun closing many of their rural branches. As a result, the per capita banking ratios in the rural areas have declined after the financial sector reform.

Also bank lending to the private sector had been constrained by the tight monetary policy of the central banks of the two countries. In Tanzania, a recent report by the Bank of Tanzania (1996) showed that in view of the restrictive monetary policy of the government, credit to all sectors of the economy declined by 50.2 percent as of the end of June 1996. This decrease in credit to the private sector was necessitated by government controls on lending abilities by the commercial banks to forestall further losses from non-performing loans.

This development in the banking sector has rekindled interest in developing a well functioning capital market (with the emphasis on the stock market) for harnessing savings for investment in long-term projects in the two countries. In the case of Tanzania, a recent study by the World Bank reports that the underdevelopment of the capital and money market is a major constraint on the government's privatization goals in the country. In addition, a recent study by the USAID team of researchers (Ott, Aggarwall, and Shayo, 1996) highlighted the plight of women in Tanzania in raising capital for business ventures. The study also points to the segmentation of the banking sector in the absence of developed capital market in leasing, trade credit, and other areas.

C. Analytical Framework

Various theories have been advanced to explain underdevelopment of SSA capital markets. The financial repression hypothesis has been at the root of the underdevelopment of the capital markets in SSA. McKinnon (1973), Shaw (1973), and Fry (1988, 1982) consider the underdevelopment of the capital market to be a direct result of government regulation of the financial sector in terms of allocation of credit and determination of interest rates.

On the other hand, Gurley and Shaw (1955, 1960) and Goldsmith (1969), postulate that economies at various levels of development possess different levels of financial structures[4]. At the early stages of economic development which is characteristic of underdeveloped countries, capital investment by business entities is mainly by self-financed or internally generated capital. However, as the economy begins to develop further, depository institutions emerge to intermediate between surplus spending and deficit spending units. These deposit institutions issue secondary securities to surplus entities to mobilize savings for allocation to the deficit entities. However, the stock markets evolve since the long-term capital needs of the business community cannot be met by the banking sector which is essentially focused on providing short-term credit to the private sector.

However, others argue that the underdevelopment of the capital market is due to the lack of an enabling environment that fosters rapid development of capital markets. A major factor is the lack of an incentive structure as a consequence of government policies of intervention in the capital markets. In addition, government monetary policy of reducing excess liquidity in the banking sector has led to high-yielding short-term risk-free government Treasury bills. This situation has resulted in higher interest rates and higher cost of borrowing by the private sector enterprises. In addition, the inflationary pressures and constant devaluation of the domestic currencies in many SSA provide no incentives for holding long-term securities.

Another element of the incentive factor is the tax structure on dividend and capital gains. For example the fiscal policy of taxing capital gains and exempting interest income on savings deposits provides a dis-incentive for holding portfolios in the stock market.

Others point to the low level of income and small size of the national economies of the SSA countries and conclude that regional and global integration of the domestic capital markets will offer greater opportunity for competing with the Southeastern Asia and Latin American countries in attracting foreign capital. Integrated capital markets allow for greater access to a wider market and more diversified source of external capital which will lead to less reliance on dwindling foreign aid. Integrated capital markets also lead to greater risk sharing by investors, especially through equity investment, and the reversal of capital flight. The assumption is that integrated markets lead to competitive markets where financial capital will seek higher returns to investment. This implies that capital market integration will be accompanied by re-allocation of capital from the markets where it is relatively abundant (in the developed countries) to the markets where it is relatively scarce (the

[4]Financial structure refers to the interaction between financial intermediaries and financial markets through which financial instruments are traded.

developing countries.)

Integrated capital markets enable corporations to operate in the international capital market by optimizing their capital structure and hedging against foreign exchange and interest rate risk. It also enables firms to minimize the cost of raising capital in the integrated international capital market. It is assumed that the marginal cost of raising capital in the domestic capital market will be higher than the marginal capital of raising capital in the international capital market.

The capital market integration is also expected to enhance the efficiency of the domestic capital market in allocating financial resources to the most productive sectors of the economy. However, in order to examine the impact of the capital market on the general economy, we will undertake an examination of the linkage between capital market development and economic growth in the two countries.

C.4. The Linkage between Capital Market Development and Growth

There have been various studies on the linkages between capital market development and real sector growth. Greenwood and Smith (1996) conclude that stock markets lower the cost of mobilizing financial savings for investing in productive business entities. Other empirical evidence strongly suggests that well functioning capital markets have the potential of promoting long-term economic growth. Such studies postulate that capital market indicators such as market liquidity, capitalization, turnover, and efficiency of allocating financial resources have strong association with economic growth and capital accumulation for high productivity. The above finding was corroborated by Smith, Bencivernag, Starr (1996) and Levine (1991) who conclude that the stock markets provide the insurance to investors of easy liquidity for selling their investments in the stock markets.

In a similar study, King and Levine (1993) conducted a cross-country study using credit as a proxy for financial market development. They find a positive relationship between financial development, real sector growth, physical capital accumulation, and economic efficiency.

Other studies postulate that functioning capital markets impact on the real sector growth through the following channels: (1) an increase in aggregate savings; (2) the efficient allocation of real savings among potential investors; and (3) an increase in the aggregate volume of investment. In addition, the development of capital markets, especially stock markets, provides greater opportunities for increased access to credit and increases the yields of financial assets, which increases financial savings and growth.

However, even though the stock markets are useful in mobilizing long-term capital for investment, the success of its operations will depend on certain preconditions. These include: (a) an enterprising private sector that can issue securities to the public; (b) political stability; (c) broad ownership of securities by the public; (d) expedient fiscal and monetary policies to stabilize inflation and the value of domestic currency; and (e) legal and regulatory reform to protect private property rights and enforce individual contracts.

D. Research program, methodology, and hypotheses

D.1. Introduction

This study is an integration of the analytical framework with a synthesis of secondary financial and primary data collected through field survey questionnaires and interviews. Descriptive statistical tests and econometric analysis based on the hypotheses would be guided by the analytical foundations and stylized facts of the capital markets of the two countries. The study will utilize parametric and non-parametric techniques in testing the hypotheses and the analysis of the issues and policy research questions that have been raised in this study.

Regression modeling and estimation will be undertaken to examine the relationships between various indices of capital market development and real sector growth in the two countries. Based on the statistical and regression analysis, various policy recommendations will be discussed.

D.2. Hypotheses

This study will examine various hypotheses based on the analytical framework and policy research questions that have been raised in the previous section of this proposal. The major hypotheses that will be tested are outlined below:

1. Macroeconomic stability is a necessary condition for the establishment and deepening of capital markets in Tanzania and Ghana.

2. Regional integration and globalization of domestic capital markets will attract greater foreign portfolio investment and reverse capital flight.

3. The development of the capital market requires healthy and viable private enterprises that have seen the benefits of broadening their shareholder base by raising capital in the stock market.

4. The microstructure of the capital markets in Ghana and Tanzania makes it difficult for small and micro enterprises to raise capital in the formal capital market.

5. The lack of credit to the private sector is a major constraint to growth in Ghana and Tanzania.

6. The development of well-functioning capital markets will enhance the prospect of privatization and restructuring of poor performing government -owned enterprises.

D.3. Methodology for testing the hypotheses

The test of the above hypotheses will utilize descriptive statistical analysis of secondary

financial data over the study period. In addition, we will undertake qualitative statistical analysis of primary data collected through field survey questionnaires and interviews in an attempt to validate the above hypotheses and policy research questions.

Parametric techniques aided by the use of the t–test statistics and the analysis of variance (ANOVA) will be utilized in the testing of the statistical significance of the various hypotheses. Of the two countries under study, the Ghana stock market provides an opportunity to conduct tests on informational efficiency.

D. 4. Market Efficiency Tests

The widely utilized methods of efficiency tests are intended to examine the speed of adjustment of security prices to new information. At the most rudimentary level, *random walk* tests provide the extent to which historical patterns of past security returns are impounded in the current price so that returns are uncorrelated serially through time. The null hypothesis indicates the absence of serial correlation in security returns. The logic is that prices change only with respect to unanticipated information in an efficient market. Given that information arrival is random then price changes (or security returns) are random and uncorrelated through time. The random walk tests are well established in the finance literature and the Ghana Stock market provides sufficient opportunity to conduct such tests.

Even though we expect that the stock market in Ghana will fail random walk tests, it should be of particular interest to assess the degree of inefficiency over time as the market becomes more liberalized and open, and as the capital market environment improves in terms of timeliness and accuracy of information disclosure.

The second approach to market efficiency relies on the effects of specific events on security prices. This is a more advanced stage of market efficiency. If markets are efficient, security prices impound the informational content of announcements, such as earnings, money supply, dividends, etc., quickly. These tests are conducted through the *event methodology*. The methodology is implemented by measuring the announcement effect on security returns in the vicinity of the specific event. For instance, positive earnings surprises increase security returns beyond the normally expected returns. The challenge is to measure the normal return in an environment of uncertainty. Typically, the market model that describes a normal relationship between a security return and the market index, is used to estimate the normal return. At the simplest level, this boils down to running a regression whereby a past series of returns are related to a past series of market index returns. The estimated coefficients are then used to predict the normal return surrounding the event window. The abnormal residuals measure the announcement effects. In an efficient market, these announcements and abnormal returns occur at the event window.

The Ghana stock market provides a third opportunity for the assessment of market efficiency. Ashanti Goldfields is cross–listed in Accra, London, New York, Toronto, South Africa, and Harare. This will then provide data to test the hypothesis of the *Law of One Price* between Accra and foreign markets. The null hypothesis indicates that the law of once price may not hold in view of the underdevelopment of the equity market in Ghana. However, our interest will be to track down

the deviations over time to see if there has been some improvement in efficiency of the Ghana stock market after the financial sector reform.

D.5. Regression modeling of the linkage between capital market development and growth

The development of the capital market evolves around the efficiency of supplying short–term and long–term capital to the private sector for productive investment. However, the extent of the capital market's impact on the real sector is not readily observable. Thus, previous authors rely on various proxies of capital market development. In addition, it is difficult to estimate the causal relationship between capital market developments and real growth of the economy. However, earlier researchers use the "endogenous growth model," by Barro (1991). This approach examines the determinants of real GDP growth as a function of various exogenous variables.

King and Levine (1993) conducted a cross–country study using credit as a proxy for financial market development. They find a positive relationship between financial development and real sector growth, physical capital accumulation and economic efficiency.

Our regression model is a synthesis of the work by Levine (1996) and Barro (1991) as follows:

$$\text{GDP per capita} = f(X, C) \qquad (1)$$

Where,

X is a vector of various macroeconomic factors other than capital market indices;
C is a vector of capital market development proxies for each country.

The above regression model can be represented in a matrix form as follows:

$$y = X\beta + u \qquad (2)$$

Where,

y is the (N x 1) column vector of observations on the dependent variable;
X is the (N x k–1) pre–determined variables;
ß is k x 1 column vector of the regression parameters;
u is (N x 1) column vector of N stochastic disturbances.

The regression model is based on the assumption that the error term is normally distributed with zero mean and constant variance or homoscedastic distribution (U ~N(0, óI). It is also assumed that there is no serial autocorrelation between the independent variables.

D.6. Regression Techniques

The regression model will be estimated by the *Two Stage Least Squares (TSLS)* estimating technique. This method has two basic advantages over the Ordinary Least Squares (OLS) method in the single equation model. It eliminates simultaneous equation bias and is also found to be more efficient than the OLS estimation method. The rational for the use of the Two Stage Least Squares (TSLS) is that in any equation model, the assumption of a unidirectional relationship is taken for granted. However, as other researchers claim, in modeling the causal relationship between capital market development and real sector growth, there exists substantial interdependence or feedback relationship between the various variables (endogenous and exogenous). Thus, the use of the Ordinary Least Squares (OLS) method, given these feedback conditions, may lead to biased and inconsistent estimators. The Two Stage Least Squares (TSLS) technique overcomes this limitations by taking care of the feedback relationship among variables appearing both as endogenous and exogenous variables in the model.
The hypotheses of the individual regression parameters will be tested with the t–statistics at the 5%, 2% and 1% levels of statistical significance. The Durbin Watson coefficients will be estimated to test for autocorrelation of the independent variables. The coefficient of determination (R2) and F – statistics will also be summarized to aid the test of the goodness of fit of the model.

E. Preliminary data and sources

E.1. Introduction

Two types of data will be collected for testing the relevant hypotheses; these are primary and secondary data. The primary data will be collected to supplement the secondary data in the analysis of qualitative aspects of the study. The secondary data will be collected to provide systematic analysis and test of the various hypotheses and the linkage between capital market developments and real sector performance.

E.2. Primary data and sources

A field survey will be conducted to administer survey questionnaires to a stratified sample of capital market institutions and intermediaries. These include private sector enterprises and the regulatory bodies (both self–regulation and statutory). The survey will be designed to elicit information on the existing challenges facing capital market development and ingredients for capacity building. Following are the outlines of survey questionnaires that may be covered during the field survey of the various samples of institutions and private enterprises.

E.3.1 Survey outline for private enterprises (Listed and unlisted)

1. Sources of financing, equity versus debt financing;
2. Capital structure and maturity profiles;
3. Corporate attitudes towards debt versus equity financing;
4. Performance and cost structure of individual firms;
5. Tax treatment of debt versus equity financing;
6. Uniform accounting practices;
7. Clearance of transactions;
8. Availability and transparency of information;
9. Management capabilities;
10. Transparency of accounting information;
11. Awareness of various sources of capital;
12. Level of confidence in the financial market for capital availability;
13. The role of formal and informal sources of capital for private enterprises;

E.3.2. Survey Outline of Ghana Stock Exchange (GSE)

1. Institutional capacity for capital market development and deepening;
2. Rules for trading practices and frequencies of trading;
4. Requirements for listings;
5. Clearance;
6. Rules governing local versus foreign investors;
7. Information technology, information efficiency;
9. Rules governing initial public offerings;
10. Disclosure rules and regulations;
11. Self regulation, compliance, and enforcement;
12. Ownership structures; are equity shares concentrated in the hands of only a small number of wealthy individuals and institutional investors?
13) Human capital development: needs assessment for trained financial and regulatory manpower;
14. Public awareness of capital markets, particularly stock markets;
15. Needs assessment for educational programs;
16. Assessment of timeliness and accuracy of financial disclosure;
17. Adherence to internationally accepted accounting standards;
18. Existence of measures for the development of unit trusts (mutual funds) and other institutional and investment funds;
19. The role of the stock exchange through privatization of government–owned enterprises.
20. Information technology;
21. Capacity for regional and global integration of capital markets.

E.3.3. Survey outline of Stock Brokers and Investment Banks

1. Trading practices;
2. Profiles of individual and institutional investors;
3. Cost structure of transactions;
4. Impact of tax structure on investment in stocks and bonds;
5. Inflationary impact on stock values and yields;
6. Government monetary policy, Treasury bills rate, and yields on stocks and bonds;
7. Any evidence of crowding out of equity issues by high yielding government Treasury bills?
8. Impact of devaluation on domestic and foreign investors;
9. Investment banking and financial management services;
10. Capacity of staff and management;
11. Company share valuation;
12. Clearance;
13. The payment system;
14. Information technology;
15. Investment instruments, developments, and deepening;
16. Market structure, organized versus over the counter trading development;
17. Public awareness of stock market and benefits;
18. Needs assessment for educational program and training of agents and advisors;
19. Informational efficiency and public confidence.

E.3.4. Survey Outline of Bank of Ghana (BOG)/Security Regulatory Commission and CMSA/Bank of Tanzania (BOT).

1. Regulation concerning the conduct of trading on the exchanges;
2. Regulation on membership of the stock exchange;
3. Regulation of foreign investment and ownership of equity shares;
4. Repatriation of dividend and capital;
5. Raising of equity or debt in the domestic market;
6. Tax policy on interest rates and dividend payments;
7. Enforcement of rules, ownership, and contract enforcement;
8. Policy measures to infuse confidence in the capital market and avert capital flight;
9. Measures to attract foreign capital;
10. Investment incentives, harmonization of domestic with international capital markets standards;
11. Foreign exchange policy and potential for reversal of capital flight;
12, Manpower and capacity of regulatory and supervisory staff;
13. Monetary policy and stabilization of macroeconomic variables.

E.3.5. Survey outline of Commercial, Merchant, and Development Banks

1. Characteristics of credit, maturity profiles, and sectoral allocation;
2. Collateral requirements;
3. Terms of loans, interest rates;
4. Profiles of beneficiaries of bank credit, company size, loan amount;
5. Investment instruments, government Treasury bills versus other investment portfolios;
6. Risk profiles, default rates, delinquency rates, non-performing loans;
7. Purchase of stocks on behalf of clients (depositors);
8. Contract enforcement;
9. Cost of funds and other transaction costs;
10. Competition from non-banking financial institutions;
11. Innovative credit instruments;
12. Underwriting of debt securities.

E.3.6. Survey Outline of Institutional Investors

1. Institutional structure;
2. Sources of funds for investment;
3. Cost structure;
4. Profiles of beneficiaries;
5. Performance of funds management;
6. Management structure and capabilities;
7. Relation with formal and informal credits organizations;

E.4. Secondary data and sources

The secondary and time series data will include consolidated balance sheets, income statements, cash flows, and other relevant financial report of the various intermediaries in the capital market. These data will be collected from commercial banks, NBFIs, brokerage houses and investment banks, and insurance companies. Other aggregate financial and macroeconomic data will be collected from: (1) Bank of Ghana, Bank of Tanzania; and (2) national sources such as the Ministry of Finance statistical divisions, etc.

In the case of the Ghana Stock Exchange, data will include stock prices, dividends for all listed stocks since the period of inception and the corresponding data for Ashanti Goldfields from London, New York, Toronto, South Africa, and Zimbabwe stock exchanges. In addition, data will be collected on indicators of stock market development such as trading volume, capitalization, listing size, turnover, etc.

F. The scope of work for field study

The scope of work for the field study is as follows:

F.1. Recruitment of field survey team and research assistants;
F.2. Training of survey team and research assistants;
F.3. Pilot testing of survey questionnaires and validation;
F.4. Survey, field work, and interviews to collect primary data;
F.5. Collection of secondary data from various sources;
F.6. Data entry and data coding;
F.7. Statistical summary and data analysis.

G. Deliverables

G.1. Various reports of PI's visits to Ghana and Tanzania;
G.2. Copies of progress reports presented at EAGER conferences;
G.3. Mid-term report;
G.4. Summaries and briefs of preliminary findings and policy implications;
G.5. Draft of final report.
G.6. Final report and policy recommendation.
G.7. Report of outcome of dissemination and policy recommendations.
G.8. Notice of publication in refereed journal(s).

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The Strategic Analysis Division

Office of Sustainable Development, Bureau for Africa

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Foreword

The purpose of the Equity and Growth through Economic Research (EAGER) activity is to support an increase in the use of economic and social science research and analysis by decision makers in public and private institutions in Sub-Saharan Africa. Two cooperative agreements (CAs) have been awarded under EAGER to date; the recipients, referred to as cooperative agreement recipients (CARs), are the Harvard Institute for International Development (HIID) and the Associates for International Resources and Development (AIRD). HIID heads a consortium of universities and consulting firms examining "Public Strategies for Growth and Equity" (EAGER/PSGE), and AIRD heads one studying "Trade Regimes and Growth" (EAGER/TRADE).

EAGER is an important initiative in the drive to make economic and social research more relevant to the policy process in African countries. The impact of this research support should include policy development and capacity-building. EAGER involves researchers, research institutions, governmental bodies, and stakeholders from the participating countries in the design and implementation of research activities. The activity also entails working with policy makers to encourage the use of research findings and recommendations in solving pressing economic and social problems.

Note to EAGER Authors

These editorial guidelines have been designed to help you prepare your research papers, policy papers, and policy briefs. Inside you will find practical advice on how to organize your reports and how to present your findings, conclusions and recommendations. Examples are provided throughout for your guidance.

You are encouraged to use a straightforward and succinct approach in your writing. Clarity and simplicity in conveying research results will greatly improve the value of your report to its readers. As you write, keep in mind that your audience may include people who do not know as much about your subject as you do. Avoid jargon and convoluted sentences, and make sure the reasons behind your recommendations will be apparent to your readers. EAGER publications should be acknowledged for their sound information and clarity of style, and it is hoped that they would comprise a practical as well as archival history of economic policy and development in the region.

This is Version Two of these guidelines, distributed with the intention that users will provide feedback on this document for future revisions. You are encouraged to share your suggestions for improvements by fax, E-Mail, or post to:

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Acronyms

ACBF	African Capacity Building Foundation
AERC	African Economic Research Consortium
AFR	Bureau for Africa
AFR/SD	Bureau for Africa, Office for Sustainable Development
AFR/SD/SA	Bureau for Africa, Office of Sustainable Development, Division of Strategic Analysis
AFR/DP	Bureau for Africa, Office of Development Planning
AIRD	Associates for International Resources and Development
CLC	Communications and Logistics Support Contract
CA	Cooperative Agreement
CAR	Cooperative Agreement Recipient
CDIE	Center for Development Information and Evaluation
CIEREA	Conference des Institutions d'Enseigment et de Recherche Economique et en Afrique
CODESRIA	Council for the Development of Economic and Social Research in Africa
CPSP	Country Program Strategy Plan
DFA	Development Fund for Africa
EAGER	Equity and Growth through Economic Research
EAGER/PSGE	EAGER/Public Strategies for Growth and Equity
EAGER/TRADE	EAGER Trade Regimes and Growth
ECA	UN Economic Commission for Africa
ESA	Eastern and Southern Africa
FY	Fiscal Year
GIS	Geographical Information System
GDP	Gross Domestic Product
HIID	Harvard Institute For International Development
M&E	Monitoring and Evaluation
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
PP	Project Paper
PSE	Personal Service Contract
PVO	Private Voluntary Organization
SSA	Sub-Saharan Africa
SSRC	Social Sciences Research Council
STATCAP	Statistical Capacity Building in Africa
UNDP	United Nations Development Program
USAID	U.S. Agency for International Development
USAID/W	U.S. Agency for International Development, Washington, DC.
WCA	West and Central Africa
WDR	World Development Report

Chapter 1

EAGER Research Documents

The ultimate goal of EAGER research is to promote the adoption of sustainable policies and strategies for achieving robust, equitable economic growth, not withstanding the numerous constraints facing most African countries. Historically, the impact of economic research in Africa has been measured by publication in Western journals rather than through tangible benefits to the countries there. Furthermore, when research has been made available to the developing country policy makers, the results are often out of date or in a form that makes them irrelevant to national policy needs. EAGER seeks to mitigate this imbalance by involving researchers, research institutions, and government bodies from the developing countries in the design and implementation of research activity from the outset and, equally importantly, by working with policy makers to put research findings to practical use in solving pressing economic and social problems.

EAGER research is to be presented in three distinct types of documents:

- Research papers
- Policy papers
- Policy briefs

Each of these outputs provides a different means of extending research results among colleagues, policy makers, and stakeholders in participating countries. By employing these different formats in disseminating research results, it will be possible to reach targeted audiences with material that is more closely tailored to their needs. While it is important that all of the different be written and organized in a clear, comprehensive, and consistent format, each will have specific requirements in order to achieve the desired result of focused relevance. These specific requirements, as well as the more general formatting requirements, will be described below[1].

Research Papers

These may be final research papers or interim working papers. The former should be under 100 single-spaced typed pages (although, longer papers may be approved when justified) and geared to audiences of researchers and other technical people.

The papers are disseminated only after they have undergone technical review and are deemed to be: suitable for publication, in service of EAGER research goals, relevant to the target audience(s), and in conformity with applicable USAID guidelines and regulations. The technical review ensures a general high quality of EAGER research papers by identifying those that require substantial revisions and editing. These reports provide a permanent record of research results and recommendations for dissemination to policy makers and colleagues.

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[1] Several other types of documents may evolve from EAGER research activities, for example, monographs and shorter pieces focusing on a particular policy issue or topic as well as articles for journal publications from research papers. The guidelines for these will be developed at a future date.

The objective of the interim reports is to provide the reader a sufficiently in-depth idea of the research issue, its dimensions, and possible options without reaching definitive conclusions. In a sense, the interim report is an overview that provides the basis for the more conclusive research paper. It should include literature reviews, descriptions of methodologies, and explanations of innovative analytical tools.

Policy Papers

Policy papers should serve as a means of presenting research findings and their policy implications to decision makers. They should thus serve to inform policy makers' search for effective solutions to policy problems. Policy papers are intended for general dissemination among professional staff of donor institutions, government officials and staff, and stakeholders in other public and private institutions. These papers should generally be no more than 20 pages.

Policy Briefs

The purpose of the policy briefs is to present a two-to-four page summary of the research findings and policy options and to highlight possible policy recommendations. They should include a clear and concise summary of the major findings of the research and key recommendations. Policy briefs are geared specifically to policy makers, but are available to a broader, more general audience as well.

The following chapters provide specific details of organizational elements as well as general guidelines about style and format for EAGER documents.

Chapter 2

Organizational Elements of EAGER Research Papers

The research papers should contain the following sections in the order shown. Each new section and chapter should begin on a right-hand page and use Level 1 headings.

Front Matter

- Cover
- Title Page
- Contents
- Foreward
- Acknowledgments (optional)
- Preface (optional)
- Executive Summary
- Glossary of Acronyms and Abbreviations (if necessary)

Body of Paper

- Introductory Chapter
- Findings and Conclusions

Recommendations

Back of the Paper

- Endnotes/Footnotes
- References/Bibliography
- Appendices (if applicable)

Front Matter

The elements in the front matter are described below in the prescribed sequence, Lower case roman numerals should be used to paginate the front matter, counting the title page as the first page and counting the blank pages as well, but starting the actual folio sequence with the Foreword, which should show the first roman numeral folio. Folios are actual page numbers, whether Arabic or roman numerals, that are typed on the pages.

Covers

Covers for all research papers under the aegis of the EAGER activity should prominently acknowledge that fact including the activity number (#698-0546). The covers also should acknowledge USAID spelled out (U.S. Agency for International Development); Bureau

for Africa, the Office of Sustainable Development, Division of Strategic Analysis—always using their full names. When there is no separate title page, all these acknowledgments should appear on the covers of final papers. Proposed covers should be included with the draft submitted for review.

Title Page

A title page is required for research papers. In addition to the stating the report's title, authors(s) and submission date, the title page should prominently acknowledge the EAGER activity and USAID with activity number and complete name, as follows: Division of Strategic Analysis, Office of Sustainable Development, Bureau for Africa, U. S. Agency for International Development, with the acronym USAID in

Table of Contents

The table of contents should be given a standard chapter heading, saying only "Contents." It should include all chapter headings, first-, second-, and third-level subheads, boxes, tables, figures, and other titled graphics.

Foreword

This is an introductory note written by someone other than the author(s). Introductory notes by the author(s) should be contained in the preface.

Acknowledgments

Inclusion of an acknowledgment section may be requested by EAGER or may be left to the discretion of a collaborator. If an acknowledgment section is included in the document, EAGER should be among the parties prominently acknowledged, using its full name.

Preface

Any introductory or incidental notes by the authors should be included in the preface. Material essential to the understanding of the text or a discussion of methodology, findings, or recommendations should not be included in the preface.

Acronyms and Abbreviations

Documents with extensive use of acronyms and abbreviations in textual and/or tabular material should include a list of Acronyms and Abbreviations in the front matter. This list should follow the table of contents and precede the executive summary. In addition, abbreviations should be defined anew in each major section of the report, that is, front matter, main body of paper, and each appendix, or if a subsequent reference appears some distance from the original reference.

Executive Summary

The executive summary should be capable of standing alone as a separate document. This summary should concisely and effectively present the key issues, methodology, findings, and recommendations of the complete report. It should not be written as if it were a

foreward, preface, or introduction. Policy briefs do not require a summary, since they are essentially summaries themselves.

Body of Paper

The body of the research paper should contain a clear and concise statement of purpose and scope of the specific research activity, including identification of target audience, relevance to the policy process, description of research methodology, findings, conclusions, and recommendations.

The elements are described below. Arabic numerals should be used for paginating the main body of the report, beginning with Chapter 1.

Introductory Chapter

This chapter should begin with a discussion of the purpose and scope of the research activity, when and where the research was conducted, the methodology used, and any special issues, constraints, or deviations from the scope of the research. A brief description of pertinent political, economic, and social factors that bear on the research activity should also be included in this chapter. The intent here should be simply to provide information about the country or activity that will help the readers understand the broad framework within which the research is conducted.

Findings and Conclusions

Findings should be presented for all research, policy papers, and briefs in a straightforward and organized fashion stating what was learned about the issues raised in the statement of purpose. The findings must be supported by presenting evidence gathered by the scope of the research.

The conclusions should sum up the findings and reflect the authors' judgment about what the findings mean in terms of specific policy objectives and strategies. Conclusions, however, are not recommendations. They should not prescribe how the situation should be or could be improved. That is the role of the recommendations.

Recommendations

Recommendations should be presented as guides to action. In the discussion that supports the recommendations, any obstacles or constraints to implementing the recommendations should be addressed along with suggestions about how they might be overcome. Alternative courses of action should be presented. The following points should be kept in mind in writing the recommendation:

- Each recommendation should flow from a specific finding and conclusion in the report. (In a long report, it may be important to cross-reference the earlier discussion.)
- Recommendations must be presented in their order of importance or grouped together so that the reader can easily distinguish major and subsidiary recommendations. It is important to remember that the recommendations are to be widely disseminated through multiple channels for use by decision makers in

private and public sectors. Precision and brevity would ensure the usefulness of the recommendations.

- Recommendations should be highlighted using numbers or bullets.

Graphics

These can include tables, charts, graphs, photographs, and drawings or illustrations. Tables are used to present numerical information, such as percentages, budget figures, survey results, and so on. All others, on the other hand, involve artwork—line drawings, photographs, maps, and charts and graphs.

Each table and figure should be given a sequential number and a title that clearly states what is shown (tables and figures should be numbered separately in order of appearance in text). Each table and figure should be referred to by number in the text.

In constructing tables and figures, authors should make sure that they can be interpreted independently of the text. If the table and/or figure is from an external source, the source must be identified in the notes at the bottom. Similarly, notes at the bottom of the table/figure should provide necessary definitions or explanations. Finally, the authors should ensure that the text and table/figure agree with each other and that all calculations are correct. Examples are provided below.

GRAPHIC	USE
Charts and Graphs	
Pie and bar charts, histograms, dot diagrams, scatter diagrams, times series curves	Illustrating patterns in data, trends, cycles, comparisons, distributions, and properties.
Organization chart	Illustrating relationships among individuals and entities
Flow chart, decision tree	Illustrating processes, options, probabilities of different outcomes
Tables	
Numerical	Ordering and summarizing numerical data to support an argument or hypothesis or serve as a reference
Maps	Illustrating spatial location and/or distribution of items or characteristics
Pictures	
Photos	Illustrating or documenting actual conditions, adding interest
Drawings	Illustrating how something works, what it looks like

Examples of some of the above are provided below.

Tables are complete in themselves; they have numbers, titles, and notes that are separate from those in the text. The purpose of a formal table is to supplement or clarify the discussion.

Table 1

Shortfalls in Funding Needed to Meet the 1995 Targets

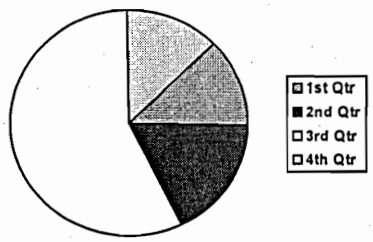
(Costs in 1989 USS, 000s)

	Urban		**Rural**		
	Water	Sanitation	Water	Sanitation	Total
Belize	**$2,913**	**$1,915**	**$990**	**$535**	**$6,353**
Guatemala	**62,257**	**78,267**	**95,736**	**11,294**	**247,554**
Honduras	**42,137**	**57,547**	**47,801**	**8,589**	**156,074**
El Salvador	**63,182**	**27,316**	**3,798**	**0**	**94,296**
Costa Rica	**38,378**	**36,328**	**10,544**	**4,618**	**89.868**
Total	**$208,867**	**$201,373**	**$158,869**	**$5,036**	**$594.,179**

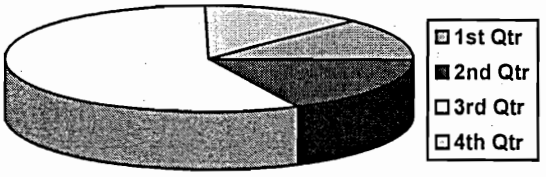
Source: USAID Field Report No. 301, Planning for Central America Water and Sanitation Programs, 1990.

Different types of graphs are useful for presenting a visual display of numerical information. For maximum effectiveness, the preparation of graphics should be part of both the research and the communication process. Layout involves choosing a graphic form, deciding on appropriate intervals, and labeling and plotting the data. Examples follow.

Pie Chart

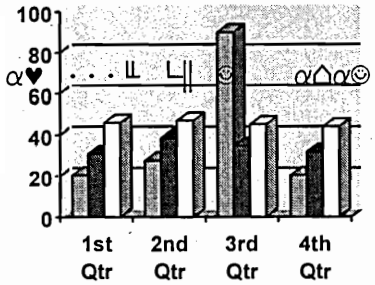


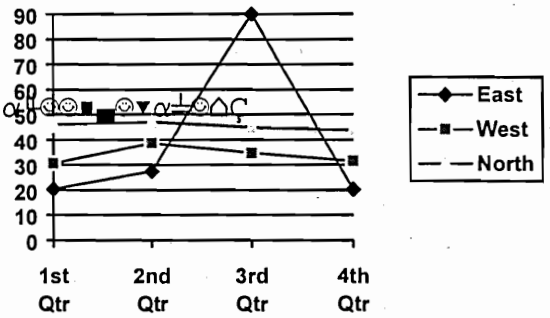
3-D Pie Chart



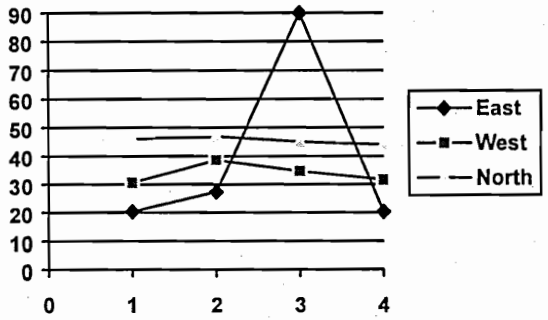
Bar Chart

Line Graph

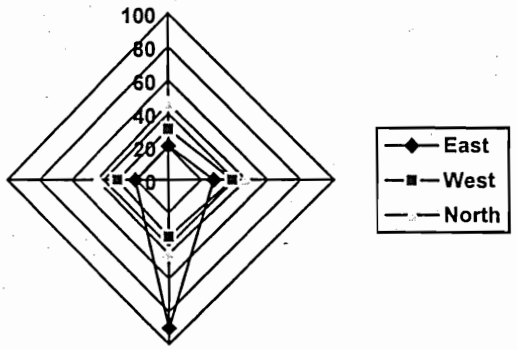




Scattergram



Radar Chart



Back of Paper

Notes

Notes documenting the text, and corresponding to reference numbers in the text, are properly called *footnotes* when they are given at the foot of the page and *notes* or *endnotes* when they are given at the end of the document or chapter. EAGER prefers that authors use footnotes, because they are easier for the reader to take into account as they read the document. Endnotes are not precluded, however. If an author chooses to use endnotes, they should go in a section titled "Notes" before the References/Bibliography.

Notes can be used to amplify statements or clarify and/or define terms. As with appendices, essential information should be in the text. Cluttering the text with notes should be avoided

Endnotes and footnotes should be numbered consecutively, beginning with 1, throughout each report or article from beginning to end. Notes in appendices start again with the number 1 for each new appendix. Footnotes should be placed beneath a thin line on the bottom of the page where they are cited.

A note number should come at the end of a sentence or at least the end of a clause, preferably follow quotations and should never be placed in heads or subheads. The use of more than one note reference at a single text location should be rigorously avoided, such

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as (5,6). Instead the notes referred to should be combined into a single note. A note that is applicable to more than one location in the text may be cited, or cross-referenced, as follows:

18. See note 3 above.

Notes to tables and other illustrative materials such as charts, graphs, or figures are numbered independently of the text notes. Letters indicate notes to such materials (such as a., b., c., and so on) and are placed below the table or illustration, not at the foot of the text page or at the end of the article.

References/Bibliography

EAGER publications use the author-date system for citations and lists of references or bibliographies. The emphasis is on clarity, consistency, and usefulness. The author means the name under which the work is alphabetized and can thus refer to an editor, compiler, or organization as well as to a single or to multiple authors. Complete references for all citations in the text should be included at the end of the report but preceding the appendices. If this section lists only publications cited in the report, it should be called References. If it contains both that are cited and not cited in the text, it should be called Bibliography.

Citations in Text

References to source documents are cited by placing the author's last name and the date of publication in parentheses at the appropriate point in the text, for example (Wilson1996). When a work by the same author and published in the same year is cited, the works are distinguished by a letter following the date, for example, (Wilson 1994a; Wilson 1994b). When there are two authors, their names are cited in the order of authorship, for example, (Wilson and Smith 1996). In case of three authors, the citation should be given as (Wilson, Smith, and Jones 1996). When a work has more than three authors, it is cited as (Wilson and others 1996).

The complete bibliographical information for the documents cited is then provided in the list of references/bibliography. The list should be paginated consecutively with the text. The list should offer the following information:

For Books and Reports

Author's name; editor, compiler, or translator's name if any; date; title of work; and facts of publication—city, publisher.

For Journals

Author's name; date; title of article; title of journal; issue information (volume, issue number); page reference.

The authors' names are inverted for all types of publications, so that alphabetical arrangement and location of individual entries may be facilitated. Arabic numerals are used for volume numbers, even when roman numerals are used in the work itself. Thus, III and CXXXVIII become 3 and 138. The major components in the citation are separated

by periods, and colons separate titles from subtitles, cities from publishers, and volumes from page. Only two type styles are used—roman and italic. After the author's last name, only the initials are given; but the full given names may be spelled out, as long as this is done consistently throughout the list. Titles are given in a sentence style—capitalizing only the first word of the main title and the subtitle and all the proper nouns and proper adjectives for books and articles; journal titles, however, are given title capitalization. The name of the journal can be abbreviated, for example, JAFED for the Journal of African Finance and Development, if the abbreviation is well-established usage, or readily recognizable. Reflecting the author-date text citation, the list entries give the date immediately after the author's name. Examples are given below.

Books

Blinkworth, R. 1987. *Converging on the evanescent*. San Francisco: Threshold Publications.

Blinkworth, R., and J.Q. Wortmaster, eds. 1953. *The collected works of G. Farthington Pennyloss*. Boston: G. F. Pennyloss.

Sanders, G. S., T. R. Brice, V. L. deSantis, and C. C. Ryder. 1989. *Prediction and prevention of famine*. Los Angeles: Timothy Press.

Organization as Author

International Monetary Fund (IMF). 1977. *Surveys of African economies*. Vol. 7, Algeria, Mali, Morocco, and Tunisia. Washington, D. C. International Monetary Fund.

International Statistics Institute. 1964. *Proceedings of the 34th Session, International Statistics Institute, Ottawa, 1963*. 2 vols. Toronto: University of Toronto Press.

Reports

Jennings, L., R. Boukraa, M. Frioui, R. Swanson, S. Thaddeus, and A. Wyatt. 1989. Midterm evaluation of the USAID/Tunisia Rural Potable Water Institutions Project. WASH Field Report No. 256. Arlington, VA.: WASH Project.

Van Wijk-Sijbesma, C. 1985. Participation of women in water supply and sanitation. Technical Paper 22. The Hague: International Reference Centre for Community Water Supply and Sanitation.

Periodicals

Arata, A. A., J. B. Vaughn, and M. E. Thomas. 1967. Food habits of certain mammals. *J. Mammal* 48, no. 6:635-55.

Additional Citations by Same Author(s)

_____. 1967. Mating habits of certain mammals. *J. Mammal* 48, no. 9:945-67.

Organization as Author in Periodical

World Health Organization. 1986. Use and interpretation of anthropometric indicators of nutritional status. *Bull. World Health Org.* 64:929-41.

Chapter in a Book or Report

MacRae, D. 1980. Policy analysis methods and government functions. In *Improving policy analysis*, edited by S. N. Stuart. Beverly Hills: Sage Publications.

UN Document

United Nations Development Program. 1 May 1992. Project Document KUW/95/003/a/01/99. Support to the Government's Public Management Reform Programme, (unsigned).

Government Report

United States Government.. Economic Report of the President. U. S. Government Printing Office. Washington, D. C. February 1996.

Annual Report

World Bank. 1995. The World Bank Annual Report, 1994. The World Bank: Washington, D. C.

Appendices

The distinction should be made among different categories of reports when discussing the appropriateness of appendices. Interim research project reports should be a shorter document intended for a limited audience. Normally extensive use of appendices is not suggested as this is concise update of research findings. The Final Report is also meant for limited distribution and should be fully documented through use of appendices so that other researchers may have access to all references. The Research Report should have few appendices since this will be the report most widely distributed.

Each appendix should be referred to briefly in the text and assigned a letter. Starting with Chapter 1, the first one should be "A," the second "B," and so on. Each appendix should be paginated separately from the body of the report, starting with page 1.

Chapter 3

Organizational Elements for EAGER Policy Papers

Policy papers are written to communicate action-oriented recommendations about policy issues and are geared to a broad audience including staff of donor institutions, policy makers in government ministries, and stockholders in other public and private institutions. The policy papers should be generally no longer than 20 single-spaced typed pages and should contain the following elements.

A. Front Matter

Covers

Covers of all policy papers under the aegis of the EAGER activity should prominently acknowledge that fact including the activity number. The covers also should acknowledge USAID spelled out (U.S. Agency for International Development); the Office of Sustainable Development (SD); Bureau for Africa, using the full names including the name of the appropriate division, that is, Strategic Analysis Division. When there is no separate title page, all these acknowledgments should appear on the covers of the paper.

Title Page

A title page is optional for research reports; however, if one is included it should prominently acknowledge EAGER and USAID with activity number and complete name, as follows: Division of Strategic Analysis, Office of Sustainable Development, Bureau for Africa, U. S. Agency for International Development, with the acronym USAID in parentheses.

Table of Contents

The table of contents should be given a standard chapter heading, saying only "Contents." It should include all chapter headings, first-, second-, and third-level subheads, boxes, tables, figures, and other titled graphics.

Foreword

This is an introductory note written by someone other than the author(s). Introductory notes by the author(s) should be contained in the preface.

Acknowledgments

Inclusion of an acknowledgment section may be requested by EAGER or may be left to the discretion of a collaborator. If an acknowledgment section is included in the report, EAGER should be among the parties prominently acknowledged, using its full name.

ıtions

The extensive use of acronyms and abbreviations in textual and/or tabular material should generate a list of Acronyms and Abbreviations in the front matter. This list should follow the table of contents and precede the executive summary. In addition, abbreviations should be defined anew in each major section of the report, that is, front matter, the main body of the paper, and each appendix, or if a subsequent reference appears some distance from the original reference.

Executive Summary

The executive summary should be capable of standing alone as a separate document. This summary should concisely and effectively present the key issues, methodology, findings, and recommendations of the complete report. It should not be written as if it were a foreward, preface, or introduction.

B. Body of Paper

The body of the report should contain a clear and concise statement of purpose and scope of the specific activity, including identification of target audience and its relevance to the policy process, description of research methodology, findings, conclusions, recommendations, and appendices. Arabic numerals should be used for paginating the main body of the report, beginning with Section 1.

Introductory Section

This section should begin with a concise discussion of the purpose and scope of the research activity, when and where the research was conducted, the methodology, and analytical tools used. A brief description of pertinent political, economic, and social factors that bear on the research activity should also be included in this section. The intent here should be simply to provide information about the country or activity that will help the readers understand the broad framework within which the research is conducted.

Findings and Conclusions

Findings should be presented in a straightforward and organized fashion stating what was learned about the issues raised in the statement of purpose. The findings must be supported by presenting evidence gathered by the scope of the research.

The conclusions should sum up the findings and reflect the authors' judgment about what the findings mean in terms of specific policy objectives and strategies. Conclusions, however, are not recommendations. They should not prescribe how the situation should be or could be improved. That is the role of the recommendations.

Recommendations

Recommendations should be presented as guides to action. In the discussion that supports the recommendations, any obstacles or constraints to implementing the recommendations

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should be addressed along with suggestions about how they might be overcome. Alternative courses of action should be presented. The following points should be kept in mind in writing the recommendation:

- Each recommendation should flow from a specific finding/conclusion in the report. (In a long report, it may be important to cross-reference the earlier discussion.)
- Recommendations must be presented in their order of importance or grouped together so that the reader can easily distinguish major and subsidiary recommendations. It is important to remember that the recommendations are to be widely disseminated through multiple channels for use by decision makers in private and public sectors. Precision and brevity would ensure the usefulness of the recommendations.
- Recommendations should be highlighted using numbers, or bullets.

Graphics

All tables, figures such as charts and graphs, and other illustrated material as well as photographs are considered graphics. Tables are used to present numerical information, such as percentages, budget figures, survey results, and so on. Figures, on the other hand, involve artwork.

Each table and figure should be given a sequential number and a title that clearly states what is shown (tables and figures should be numbered separately in order of appearance in text). Each table and figure should be referred to by number in the text.

In constructing tables and figures, authors should make sure that they can be interpreted independently of the text. If the table and/or figure is from an external source, the source must be identified in the notes at the bottom. Similarly, notes at the bottom of the table/figure should provide necessary definitions or explanations. Finally, the authors should ensure that the text and table/figure agree with each other and that all calculations are correct. Examples are given in Chapter 2 on pages 17 and 18.

C. Back Matter

Appendices

Policy papers should not be loaded down with appendices, which add more to the bulk of papers that are intended to be concise documents. Only exceptionally pertinent, brief, and necessary material should be appended to the policy paper.

Each appendix should be referred to briefly in the text and assigned a letter. Starting with Section 1, the first one should be "A," the second "B," and so on. The pagination for the appendices should not be sequential with the text but should start anew at the number 1.

Notes

Notes documenting the text, and corresponding to reference numbers in the text, are properly called *footnotes* when they are given at the foot of the page and *notes* or *endnotes* when they are given at the end of a report, or chapter, or the end of an article in a journal. EAGER prefers that authors footnotes. Should an author choose to use endnotes, however, they shouls go in a section titled "Notes" before the References/Bibliography.

Notes can be used to amplify statements or clarify and/or define terms. As with appendices, essential information should be in the text. Cluttering the text with notes should be avoided

Endnotes and footnotes should be numbered consecutively, beginning with 1, throughout each report or article from beginning to end and called out in the text with Arabic numerals in parentheses. Notes in appendices start again with the number 1 for each new appendix. Footnotes should be placed beneath a thin line on the bottom of the page where cited.

A note number should come at the end of a sentence or at least the end of a clause, preferably follow quotations and should never be placed in heads or subheads. The use of more than one note reference at a single text location should be rigorously avoided, such as (5, 6). Instead the notes referred to should be combined into a single note. A note that is applicable to more than one location in the text may be cited, or cross-referenced, as follows.

18. See note 3 above.

Notes to tables and other illustrative materials such as charts, graphs, or figures are numbered independently of the text notes. Letters indicate notes to such materials (such as a., b., c., and so on) and are placed below the table or illustration, not at the foot of the text page or at the end of the article.

References/Bibliography

EAGER publications use the author-date system for citations and lists of references or bibliographies. The emphasis is on clarity, consistency, and usefulness. The author means the name under which the work is alphabetized and can thus refer to an editor, compiler, or organization as well as to a single or to multiple authors. Complete references for all citations in the text should be included at the end of the report but preceding the appendices. If this section lists only publications cited in the report, it should be called References. If it contains both that are cited and not cited, it should be called Bibliography.

Citations in Text

References to source documents are cited by placing the author's last name and the date of publication in parentheses at the appropriate point in the text, for example (Wilson1996). When a work by the same author and published in the same year is cited, the works are distinguished by a letter following the date, for example, (Wilson 1994a; Wilson 1994b). When there are two authors, their names are cited in the order of authorship, for example, (Wilson and Smith 1996). In case of three authors, the citation

should be given as (Wilson, Smith, and Jones 1996). When a work has more than three authors, it is cited as (Wilson and others 1996).

For Books and Reports

Author's name; editor, compiler, or translator's name if any; date; title of work; and facts of publication—city, publisher.

For Journals

Author's name; date; title of article; title of journal; issue information (volume, issue number); page reference.

The authors' names are inverted for all types of publications, so that alphabetical arrangement and location of individual entries may be facilitated. Arabic numerals are used for volume numbers, even when roman numerals are used in the work itself. Thus, III and CXXXVIII become 3 and 138. The major components in the citation are separated by periods, and colons separate titles from subtitles, cities from publishers, and volumes from page. Only two type styles are used—roman and italic. After the author's last name, only the initials are given; but the full given names may be spelled out, as long as this is done consistently throughout the list. Titles are given in a sentence style—capitalizing only the first word of the main title and the subtitle and all the proper nouns and proper adjectives for books and articles; journal titles, however, are given title capitalization. The name of the journal can be abbreviated, for example, JAMA for the Journal of American Medical Association, if the abbreviation is well-established usage, or readily recognizable. Reflecting the author-date text citation, the list entries give the date immediately after the author's name. Examples are given below.

Books

Blinkworth, R., and J.Q. Wortmaster, eds. 1953. *The collected works of G. Farthington Pennyloss.* Boston: G. F. Pennyloss.

Sanders, G. S., T. R. Brice, V. L. deSantis, and C. C. Ryder. 1989. *Prediction and prevention of famine.* Los Angeles: Timothy Press.

Organization as Author

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Policy Briefs

The policy brief is the distillation of policy research geared specifically to busy decision makers, but is also disseminated to a broader, more general and non-technical audience of opinion makers. The brief should be written as a 2 to 4 single-spaced typed summary of (1) policy research findings, (2) policy options, and (3) key recommendations. Clarity, immediacy, and accessibility are of the essence in framing the policy dialogue and offering practical solutions to precisely defined problems. Covers for policy brief should follow the format described for the other EAGER documents above.

Chapter 4
Style and Format

A. Style

- EAGER authors should strive for clear, concise, and jargon-free writing.
- Avoid lengthy sentences or overly dense paragraphs.
- Explain and define technical terms, abbreviations, and acronyms.
- Use the active voice, it injects immediacy and directness to the writing.
- Use italics for titles of books and journals in the text, unfamiliar foreign words, and words that require special emphasis. Bold type occasionally may be appropriate for highlighting specific recommendations; however, underlining should not be used, because it interferes with the readability of the material. However, the use of bold type and italics to add emphasis should be avoided.
- Lists of short items of 10 lines or fewer should be typed in block form, and preceded by bullets or numbers, not by dashes. Bullets are preferable to numbers, unless the number of items itself is significant.
- EAGER recommends standard American spelling. Substitute English for Latin usage.
    - for example, *not* e. g.
    - and so on, *not* etc.
    - and others, *not* et. al.

Some general rules of grammar, usage, and punctuation are set here for EAGER's authors. They are organized alphabetically.

Commas

Use the serial comma to separate all items in a list, as shown in example below.

A research report, a journal article, and a chapter in a book...

Dates

Commas should be used only when there are more than two elements.

April 1996 (no comma)

April 20 (no Comma)

April 20, 1996 *or* 20 April 1996

Years should be set off from text by commas.

The policy was instituted on April 20, 1996, by presidential decree.

Centuries and Decades

twentieth century; twenty-first century (not 20th century)

1990s (not 1990's or '90s) the nineties

Governmental Bodies

Capitalize if referring to a specific body; lower case if generic:

Russian Ministry of Health; ministry of health officials around the world

Parliament; parliaments, parliamentarians

U.S. Government; Government of the United States of America

Hyphens

Compound adjectives are generally hyphenated except for "ly" adjectives:

Top-down management; long-term effects

centrally funded program

Relatively few nouns are hyphenated:

From the top down; over the long term

cost-effectiveness

Words beginning with prefixes "re," "inter," or "multi" are not hyphenated, even when the prefix is followed by a vowel:

Revise, reinvent, reassess, international, interagency, interdisciplinary, multipurpose, multilateral, multinational.

When several adjectives are listed to modify a single noun, they should all be hyphenated:

Low- and middle-income groups

Numbers

Numbers should be spelled out:

up to 10 (one through nine)

At the beginning of a sentence (Seventy-five years ago)

Use either numerals or spelled out numbers in comparative lists, but be consistent:

A total of 123 people died of disease in 1918, but only 4 died in 1990.

There were three participants who agreed and fourteen who did not.

Quotation Marks

Quotation marks always fall *outside* commas, periods, question marks, exclamation points, and ellipses; there are no exceptions.

Quotation marks always fall *inside* colons, semicolons, and dashes.

Ratios

Hyphenate ratios and be consistent in spelling out numbers or using numerals:

two-to-one majority

the odds were 15-to-1 (not one)

Titles and Honorifics

Capitalize title when they are part of the name:

President Nelson Mandela; Nelson Mandela, president of South Africa; the president

B. Format

- Use a standard, proportionally spaced 10-12 point serifed font for the text typeface, such as Times Roman.
- Center page numbers (folios)at the bottom of each page.
- Do not show folios on blank pages but count them in pagination.

Titles and Headings

The type size used for heads and subheads should be in descending order to show subordination. Four levels of heads should suffice for organizing most documents. The use of oversized type or too many typefaces can make the page look jumpy and can effect readability. Number one heads should be used for all new sections and chapters. Arabic numerals should be used to indicate the number of each section or chapter, for example, Section 1, Chapter 4. Capital letters should be used to indicate Appendices, for example, Appendix A, Appendix B. EAGER suggests the following styles for headings.

Level 1 headings :

- Use noticeably larger type size than body text (For example, if text type is 12 points, make this level 16 points)
- Make it upper and lower case, bold type, and centered

Level 1 subheadings also should be used for chapter or section subtitles, as shown in the example below:

Chapter 1
Introduction

Level 2 headings:
- Use slightly larger than the body text (14 points)
- Make it upper and lower case, bold type, and flush left, as shown in example below:

Research Methodology

Level 3 headings:
- Use the same font and size as the body text (12 points)
- Make it upper and lower case, bold type, and flushed left as shown in example below:

Research Literature

Level 4 headings:
- Use the same font and one size smaller than the body text (11 if the body text is 12 points)
- use upper and lower case, bold italic type, and flush left, as in example below:

Examples of parallel research

Avoid using more than four levels of headings, but if the text demands it, make the fifth level the same size as the text, italicized, and run it in with the text, as shown in example below:
Hyphens. Compound adjectives are often hyphenated.

Use artificial page breaks in two circumstances only:
- to enable section and chapter headings to begin at the top of the right-hand page
- to prevent other subheads from appearing at the base of a page and followed by fewer than two lines of text.

EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH
PUBLIC STRATEGIES FOR GROWTH WITH EQUITY
(EAGER/PSGE)

ENHANCING TRANSPARENCY IN TAX ADMINISTRATION

Study team:

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Discussion Paper

United States Practice in Estimating and Publicizing Tax Evasion

by Clive Gray

January 28, 1998

EAGER is a project of USAID's Africa Bureau, Office of Sustainable Development, Division of Strategic Analysis (AFR/SD/SA). EAGER's PSGE component is being carried out pursuant to Cooperative Agreement No. AOT-0546-A-00-5133-00 between the U.S. Agency for International Development (USAID) and Harvard University. Views and interpretations in this document are those of the author and should not be attributed to USAID or Harvard.

United States Practice in Estimating and Publicizing Tax Evasion

Background to EAGER study

In every country a greater or lesser proportion of taxes that are legally due is evaded. Evasion has three components: (1) taxpayers supplying information to the tax services understate the base on which taxes are due, (2) persons or enterprises that are legally obligated to supply information to the tax services refrain from doing so, and (3) taxpayers fail to remit payments which they themselves or the tax services estimate to be due. In this paper the extent of evasion is defined as the ratio of evaded taxes to taxes legally due, while the ratio of tax collections to taxes due (= 1.0 less the evasion ratio) constitutes our measure of a given country tax system's performance.[1]

Estimating the extent of evasion is no exact science, and I know of no effort to draw a comprehensive cross-country comparison. However many indicators show evasion to be substantially greater in former centrally planned economies and in Africa than in established market economies. Moreover there is general agreement on two factors that make for a potentially high social return to measures for combating evasion in those countries:

(a) such measures constitute a cost-effective means of lowering the budget deficit, thereby reducing inflation and/or freeing up resources for public expenditure on sectors that are at present inadequately served, notably social and physical infrastructure;

(b) provided that the tax system as established by law has a less distortionary impact on economic incentives than the patchwork of taxes actually enforced, reducing evasion lessens the distortionary effect of taxation.

Countless approaches to reducing evasion by reform of tax administration have been proposed and tried in Africa. In light of the buffeting to which political predation and resulting inflation have subjected most African civil services, reformers in a number of countries have concluded that asking run-of-the-mill, underpaid bureaucrats to pursue taxpayers is a recipe for a chronic budget deficit. Accordingly, countries such as Ghana, Kenya, Tanzania and Uganda have established quasi-autonomous revenue authorities with a more generous salary structure than that of the civil service.

The present EAGER/PSGE research project on "Enhancing Transparency in Tax Administration" does not aspire to a systematic review of measures for reducing tax evasion. Apart from attempting to estimate the extent of evasion, the project's two field studies in Madagascar and Tanzania are limiting their analysis of remedies to considering the *process* of measuring evasion and disseminating the resulting estimates. Few if any African tax administrations, or ministerial departments (notably, finance ministries) concerned with tax policy, undertake systematic, regular estimation of tax evasion, and report findings publicly. In any case this does not happen in Madagascar or Tanzania.

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[1] No pretense is offered that this mechanical gauge of administrative performance measures a tax system's economic efficiency. Such measurement would involve, at the most naive level, a cost-benefit analysis to determine at what point the marginal social cost of compliance and collection offsets the marginal social benefit of public *versus* private use of funds; the ultimate in sophistication, applying optimum tax theory, would involve comparing the net social benefit of the existing tax system with an ideal system that minimized the distortionary impact of taxation, given assumed objectives with respect to equity and growth of output.

The basic premise underlying the initial proposal and final design of the study was that an African government--indeed, any government--can improve the performance of its tax service by undertaking this process. Following are some key hypotheses in this connection that were either advanced in the initial documentation or have emerged in discussions during the course of the research:

- As tax evasion becomes an object of open discussion, involving debate in parliament, campaign speeches, resolutions by stakeholder groups, etc., pressure will build on major offenders to reduce the extent of their evasion, and on political leaders, from the head of state on down, not only to reduce their own evasion (since they frequently number among the largest offenders) but also to push the tax services into increasing collections, or at least to refrain from obstructing the services as and when they pursue prominent evaders.
- The greater the level of detail in publicly distributed reports on tax evasion, the closer they will come to identifying and embarrassing the largest evaders, as well as pressuring the tax administration, both managers and their political overseers, to increase collections from them. For example, if a published report reveals that only ten companies or ten individuals declared 1997 taxable income in excess of sh.10 million, paying X million in tax, serious economic journalists and other commentators can say, "Every observant individual in this country knows at least 25 companies/individuals whose profit/income, or expenditure therefrom, obviously exceeded sh.10 million," or alternatively "The income consistent with widely observed consumption expenditure by this country's ten greatest spenders should have generated ten times as much tax at established rates".
- In many African countries, a sizable share of tax delinquency is accounted for by state-owned enterprises (SOEs), and politically-directed lack of pursuit constitutes implicit subsidization of them by government. Increasing the public light shed on this phenomenon may augment understanding of the true social cost of SOEs and add support to moves to privatize or liquidate them.
- Publicly disseminating estimated evasion rates establishes a baseline against which the tax services' performance can be measured more precisely than is now the case, and permits the posting of quantitative targets for reducing evasion.
- Providing tax administrators and policy analysts with systematic estimates of tax evasion allows them to allocate collection and enforcement resources more efficiently, i.e. so as to come closer to maximizing collection of delinquent taxes for a given investment of resources.

Practice in the United States

Measuring the tax "gap".[2]

Relative importance of direct taxation in the U.S. In financing public expenditure the U.S. federal government relies heavily on direct taxation. Table 1 shows income taxes (individual and corporate) accounting for 85 percent of U.S. federal receipts in 1995 excluding social insurance

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[2] This section is based on IRS reports (notably IRS 1997a) and on congressional testimony of the General Accounting Office (GAO 1997) reviewing IRS practice.

taxes and contributions (SIT&C), and 54 percent of total receipts including them.[3]

Table 1 - SOURCE DISTRIBUTION OF U.S. FEDERAL GOVERNMENT RECEIPTS, 1995

Source	$ bill.	Percentages of: Subtotal excluding social insurance	Total receipts
Direct taxes - subtotal	788.5	86.7%	55.2%
Income taxes - subtotal	773.5	85.1%	54.2%
Individual	627.7	69.0%	44.0%
Corporation	145.8	16.0%	10.2%
Estate and gift taxes	15.0	1.6%	1.1%
Indirect taxes - subtotal	93.0	10.2%	6.5%
Excise	71.7	7.9%	5.0%
Customs	21.3	2.3%	1.5%
Miscellaneous receipts	27.6	3.0%	1.9%
Subtotal, receipts excluding social insur.	909.1	100.0%	63.7%
Social insurance taxes & contributions	518.3		36.3%
(On-budget)	143.6		10.1%
(Off-budget)	374.7		26.3%
TOTAL RECEIPTS	1427.4		100.0%

Source: OMB (1997), page 28.

Table 2 draws on data from the IMF's *Government Financial Statistics Yearbook - 1997* to compare the U.S. with other countries in regard to roles of different tax categories. U.S. taxes on income, profits and capital gains accounted for 54.1% of federal revenue in 1996, against an unweighted average of 31.4% for 21 other industrial countries.[4] The *GFSY* source shows only Australia and New Zealand with even higher shares of direct taxation (64.5% and 62.0%

[3] Table 1 gives revenues in two variants, including and excluding SIT&C. Interest in the variant excluding social insurance payments arises because evasion of these payments raises a set of issues somewhat tangential to our central concern in studying tax compliance in Africa. In the first place, no African country has a social insurance system whose fiscal weight is comparable to that in industrial countries, and SIT&C account for a much lower proportion of receipts of African governments--averaging 7.6% for the 22-country sample featured in Table 2. Secondly, the fledgling social insurance systems that exist operate on a "Pay as you earn" (PAYE) basis, such that benefits are financed by current receipts, and not allowed to exceed them. In some industrial (and especially transition) economies where an excess of benefit payments over current receipts is a charge on other government revenue, SIT&C compliance is an issue of concern to overall fiscal policy.

[4] IMF (*1997*), pp. 4-5. The total revenue base includes social insurance taxes and contributions. U.S. data relate to 1996, those for other countries relate to single years between 1992 and 1996. Unweighted averages calculated by the author. Apart from reference to a different tax year, differences in definition cause slight discrepancies between Table 1 and *GFSY* data for the U.S.

respectively).

Conversely, as regards domestic taxes on goods and services, these account for only 3.5% of U.S. federal revenue, as against an unweighted average of 30.2% for the 21 other industrial countries. Taxes on international trade are equally insignificant in the U.S. and its industrial counterparts.

The contrast is even more dramatic between the U.S. and Africa. Unweighted averages for 22 African countries, calculated from the same *GFSY* table, show direct taxes accounting for 22.9% of revenue, while domestic taxes on goods and services account for 27.1% and taxes on international trade, at 29.4%, are the single most important source of revenue in Africa.

Measuring compliance with direct taxes in the U.S. Given the importance of direct taxes in federal revenues, it is natural that the bulk of the effort devoted to measuring the U.S. tax "gap" goes into estimating evasion of income tax.

For over thirty years, beginning in 1963, the Research Division of the U.S. Internal Revenue Service (IRS) conducted a periodic exercise called the Taxpayer Compliance Measurement Program (TCMP). The core of this program consisted of auditing returns--the IRS describes the process as an "intensive line-by-line audit"--of a random sample of individual income tax payers, measuring their net understatement of income and overstatement of deductions, exemptions, etc., and projecting the outcome to the entire population of taxpayers. Less frequently the IRS identified and sampled a population of non-filers, computing their tax liability and then projecting it to the total population in question.

Recent IRS estimation of undeclared income, including that for 1992 covered in Table 2, made no attempt to include illegal income such as that from drug-dealing and prostitution. Estimates published in 1979 and 1983 included such income, but, according to the GAO, "since then, IRS researchers have decided that the data and methodology for reliably making this estimate are lacking".[5]

To these estimates of understatement of tax and failure to file returns the IRS added delinquent amounts arising from taxpayers' failure to pay, and the Service's inability to collect, the full amount of their acknowledged liability. A portion of delinquent amounts comprises money that employers withhold from their employees' wages, but then fail to remit to the IRS.

Apart from analyzing the "gap" with respect to the individual income tax, the IRS also estimated and reported, albeit less regularly, the gap with respect to income tax payable by large and small corporations. (The dividing line between large and small is $10 million worth of assets.) The estimation procedure with respect to small corporations was similar to that for individual income tax--a random sample of returns was audited line-by-line; the population of companies failing to file returns was sampled; and the resulting figures, plus delinquent amounts, yielded estimates of evasion.

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[5] GAO (1997), p. 3.

Table 2 - TYPES OF REVENUE AS PERCENTAGES OF TOTAL REVENUE, INDUSTRIAL COUNTRIES AND AFRICA

	Taxes on Income, Profits and Capital Gains			Social Security Contribs.	Taxes on Payroll and Work Force	Taxes on Property	Taxes on Domestic Goods and Services		Taxes on Internat'l Trade & Transacs.	Other Taxes	NonTax Revenue	Taxes on Entre-preneurial and Property Income
	Total	of which: Individ.	of which: Corpor.				Total	of which: Gen.Sales, Turnover or VAT				
Industrial Countries												
Unweighted averages, 21 countries excluding Belgium & Germany												
Including U.S.	32.4	23.9	7.9	25.9	2.1	2.4	29.0	18.7	1.4	1.2	10.0	6.0
Excluding U.S.	31.4	22.9	7.7	25.5	2.1	2.5	30.2	18.7	1.4	1.2	10.1	6.1
United States	54.1	42.9	11.2	33.0	0.0	1.1	3.5	0.0	1.3	0.0	7.0	3.8
Africa - unweighted averages of 22 countries*												
	22.9	10.7	10.4	7.6	0.7	1.1	27.1	15.2	29.4	1.8	15.5	9.0

* Due to missing data, averages for breakdown of direct taxes exclude Kenya and indirect tax figures exclude Burkina Faso.

Conversely the "gap" estimate for large corporations was based on the supplemental liability, over and above firms' self-assessment, estimated by IRS auditors in the normal course of processing those returns. The uncertainty that surrounds a complex tax code and the resulting possibility of reasonable differences of interpretation introduces an element of ambiguity in ascribing the full amount of the discrepancy in question to a tax "gap".

Table 3 gives a breakdown of IRS estimates for the 1992 individual and corporate income tax gaps, and shows the estimated gaps as percentages of total liability. In a nutshell, individuals were estimated to voluntarily declare and pay 83% of their income tax liability, while an additional 4% was subsequently recovered through IRS enforcement actions, leaving a "net tax gap" of 13%. The sources consulted for this paper do not break down collections or estimated tax liability between large and small corporations, thus preventing us from distinguishing the estimated tax evasion rates between the two sub-categories. Nor do the sources provide data on subsequent recovery of corporate income tax liabilities, thus leaving us without a basis for estimating the "net" tax gap for that category.

Table 3 - GROSS TAX GAP ESTIMATES FOR TAX YEAR 1992

Source of tax gap	Total tax liability ($ bill.)	Gross tax gap ($ bill.)	Gross tax gap % of total gap	Gross tax gap % of liability	Subsequent collection through enforcement ($ bill.)	Net tax gap Amount ($ bill.)	Net tax gap % of liability
Individual tax gap - total (a)	$550-552	$ 95.3	74.3%	17.3%	$ 15.0	$ 80.0	14.5%
Errors in filed returns:					$ 6.9		
Underreported income, of which:		$ 58.6	45.6%				
Business income of sole proprietors		$ 29.2	22.7%				
All other income		$ 29.4	22.9%				
Overstated deductions		$ 14.4	11.2%				
Nonfilers		$ 13.8	10.7%				
Individual remittance gap		$ 8.4	6.5%				
Corporate tax gap - total	$133.4	$ 33.1	25.8%	24.8%			
Small corporations		$ 7.0	5.5%				
Large corporations		$ 23.7	18.5%				
Other (b)		$ 0.4	0.3%				
Corporate remittance gap		$ 2.0	1.6%				
		$128.4	100%				

(a) Includes $0.1 billion for arithmetical errors
(b) Refers to unrelated business income of exempt organizations, and fiduciaries
Source: General Accounting Office (1997) and Internal Revenue Service (1997), p. 18.

Indirect taxes. Given the absence of a national sales or value-added tax and the generally low level of import duties and absence of other taxes on international trade--Table 2 puts the total share of indirect taxes at 4.74%--it is obvious that noncompliance with respect to such taxes has much less impact on government revenue in the U.S. than in most other countries. This is especially true in comparing the U.S. and Africa, where Table 2 shows indirect taxes averaging 56.5% of revenue for 22 countries.

Referring to the tax year 1995 and using slightly different definitions from the *GFSY*, Table 1 shows federal excise taxes accounting for 5 percent of total federal receipts in 1995, and about 8 percent of non-SIT&C receipts. Official estimation of evasion of these taxes is less systematic than that concerning direct taxes. In its 1992 Annual Report, the IRS limits discussion of noncompliance to excise taxes on motor fuel. The report refers to a 1989 estimate by the Department of the Treasury's Office of Tax Analysis of $250 million in unpaid motor fuel excise taxes.[6] Of this amount as much as 40 percent was estimated to correspond to "criminal activity", i.e. deliberate attempts to defraud the government.

In 1997 35 indictments resulted from a single investigation of evasion of federal and state taxes on diesel fuel in Pennsylvania, New Jersey and other neighboring states. Typically, operators of truck stops destroyed fuel purchase and sales records, rolled back meters on pumps and filed false tax returns.[7]

In the U.S. as elsewhere, smuggling, defined to include underdeclaration as well as total evasion of taxes on imports and exports, deprives the federal government of revenue. However, with Customs duties budgeted to provide only 1.5 percent of total revenue (2.3 percent of non-SIT&C revenue), the portion of the federal tax gap accounted for by smuggling is minuscule.

Transparency with respect to the tax gap in the U.S.

For purposes of the present EAGER study, the question of the degree of official transparency to which tax evasion in the U.S. is subject is of greater interest than its measurement.

Published estimates of aggregate evasion. As of 1996, the IRS' Compliance Research office employed several hundred persons, distributed among units such as an Applied Research Branch and an Economic Analysis and Modeling Group.[8] Since the TCMP's inauguration in 1963, its reports have been published by the IRS and distributed by the Service itself as well as being sold for a nominal charge by the Government Printing Office (GPO). The latest report, *Federal Tax Compliance Research - Individual Income Tax Gap Estimates for 1985, 1988, and 1992*, apart from being sold as IRS Publication 1516 (Rev. April 1996), is available free of

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[6] IRS (1993), p. 11.

[7] *Pittsburgh Post-Gazette*, October 26, 1997, "Three charged in fuel tax fraud".

[8] IRS (1997a), Table 31, shows 835 staff employed in Compliance Research/SOI (statistics of income) at end-1996. The breakdown between those two functions is not shown.

charge on the IRS' web site. That 60-page document lists, as references, nine reports or articles, along with one unpublished conference paper, published since 1988 under the authorship of the IRS or individual staff members. These titles are included among References at the end of this paper.

Within the General Accounting Office (GAO), an agency that evaluates U.S. Government operations on Congress' behalf, reviewing the IRS is the principal task of an office entitled Tax Policy and Administration Issues in the GAO's General Government Division. Recently the section's director has delivered testimony on TCMP and IRS findings on other compliance issues to Congressional subcommittees and to the National Commission on Restructuring the Internal Revenue Service, a body established jointly by the President and Congress.[9] These bodies of testimony are sold by the GAO Document Distribution Center and available free of charge on the web; Congressional committee testimony is distributed by the GPO.

Apart from testifying to Congressional committees, the GAO has taken several initiatives to illuminate issues of taxpayer compliance and suggest means of improvement. A 1992 report focussed on compliance by independent (self-employed) contractors, a group which the IRS labels "informal suppliers".[10] In 1995 the GAO sponsored a symposium on "Reducing the Tax Gap" whose proceedings have been publicly distributed.[11]

Recently the burden on taxpayers of complying with IRS regulations has become a political issue, with both the Clinton Administration and Republican and Democratic members of Congress rushing to expose instances of harassment of taxpayers and suggest ways of curbing these. Concern with the burden on taxpayers of the detailed TCMP audits, as well as pressure to reduce IRS costs, led the Service in late 1995 to cancel a planned 1994 TCMP, prompting the GAO to refer to "the demise of TCMP".[12] The GAO report continued: "It is not yet clear whether IRS will be able, absent TCMP data, to continue to provide a comprehensive tax gap estimate with any statistical precision at the national level."

In effect, taxpayers' burden has become part of the cost that is factored in when IRS, GAO, Congress and other stakeholders debate the question of cost-effective measures for increasing taxpayer compliance. Even greater attention is focussed on moves to increase compliance by simplifying the tax code and thus reducing compliance costs.

Publicity regarding tax enforcement. The component of transparency that constitutes the strongest incentive for tax compliance is clearly the publicity given to prosecution and conviction of individual tax evaders. In 1996 the IRS Criminal Investigation Division (CID), employing about 5,000 persons or five percent of the total IRS staff complement, referred

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[9] GAO (1996, 1997).

[10] GAO (1992).

[11] GAO (1995).

[12] GAO (1997) p. 5.

3,600 cases for prosecution to the Department of Justice (DoJ).[13]

Publicity regarding tax fraud is handled by the latter department, via the office of the U.S. Attorney in the district where a given case is prosecuted. That office normally issues a press release when a tax evader is indicted, once he or she is convicted, and again when the evader is sentenced. Appendix 1 below gives a sample of each type of press release, issued in the last quarter of 1997 by the U.S. Attorneys for Massachusetts and Western Pennsylvania. Appendix 2 reproduces the statement of purpose from the CID's 58-page *Publicity Guidelines*. The Division's Policy & Information Division compiles a volume of monthly news clippings whose October 1997 issue contains a hundred or so news articles from around the country, bearing on prosecution of tax evasion.

Table 4, Part A, gives data on the IRS Criminal Investigation Program, while Part B summarizes delinquent collection activity. The bottom line is that, in 1996, nearly 3,000 persons were convicted of tax fraud, of whom about 2,800 were sentenced and close to 2,200, or nearly 80%, sent to prison. Over a third (35.0%) of those imprisoned were apprehended under the IRS' Narcotics Program, where persons engaged in illegal drug activity are prosecuted for failing to declare, and pay tax on, income from that activity.

Would-be tax evaders are also put on notice by the IRS' publicity regarding collection from delinquent taxpayers whose default is not viewed as passing the threshold of criminal intent. Part B of the table shows the Service filing 750 notices of federal tax lien; serving over 3,000 notices of levy on third parties--mainly employers, through whom wages are garnisheed; and, in a small number of cases (ten), seizing property.

Conclusion

U.S. practice in measuring and publicizing evasion of direct taxes offers models that can be applied by tax administrations in Africa. We abstain from saying "easily" applied, because ease of application is partly a function of the level of counter-pressure from the oligarchs whose large-scale evasion accounts for most of the tax gap. The present EAGER study is conceived as an additional input in the process of equipping African tax authorities with knowledge about ways of enhancing transparency to increase pressure on tax evaders, while raising public awareness of tax evasion as a contributing factor to inflation and underfunding of public goods.

Because the U.S. federal model reviewed here focuses much less on evasion of indirect taxes, in view of the composition of government revenue in Africa, studies of tax compliance there have to look elsewhere for guidance on measuring and publicizing evasion of sales and excise taxes, VAT, and import duties. That will be the subject of an ensuing EAGER Discussion Paper.

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[13] Breakdown of employees given in IRS (1997), Table 31. Source uses functional rather than organizational categories, giving a figure of 5,060 (of whom 3,352 are listed as "Special Agents") for staff engaged in "Tax Fraud & Financial Investigation", which may differ slightly from the CID's staff complement.

Table 4 - I.R.S. CRIMINAL INVESTIGATION AND DELINQUENT COLLECTION PROGRAMS - 1996

Part A - Criminal Investigation Program (figures refer to numbers of cases)

Program	Initiated	Discon-tinued	Referred for prosecution	Indictments	Convictions	Sentenced	Sent to prison	% to prison
Fraud	4,001	1,264	2,573	2,282	2,028	1,914	1,401	73.2%
Narcotics	1,333	293	1,032	992	887	863	755	87.5%
Total	5,334	1,557	3,605	3,274	2,915	2,777	2,156	77.6%

Part B - Delinquent Collection Activity	Opening inventory	Issuances	Dispositions	Closing inventory
	(figures refer to numbers of cases)			
Taxpayer delinquent accounts	5,711	5,053	4,998	5,766
Delinquent return investigations	2,066	1,792	1,684	2,174
Offers in compromise received: 134				

Enforcement activity (no. of cases)			Yield from taxpayer delinquent accounts ($ billions)			
Notices of federal tax lien filed	Notices of levy served on 3rd parties	Seizures of propert	First bill	Subsequent bills & installment agreements	Additional action	Total yield
750	3,109	10	$9.4	$11.3	$9.0	$29.7

Source: Internal Revenue Service, 1996 Annual Data Book, Publication 55B, Tables 20 & 21

BEST AVAILABLE

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Appendix 1

Sample of 1997 News Releases from United States Attorneys for Districts of Massachusetts and Western Pennsylvania

Regarding

Criminal Indictment, Conviction and Sentencing of Tax Evaders

U. S. Department of Justice

United States Attorney

District of Massachusetts

1003 J.W. McCormack Post Office & Courthouse
Boston, MA 02109

November 19, 1997

PRESS RELEASE

FORMER SUDBURY WASTE HAULER CHARGED WITH TAX OFFENSES

Boston, MA ... United States Attorney Donald K. Stern announced today that **Howard S. Hatch**, of Manchaug, Massachusetts, was charged in U.S. District Court with filing false Federal income tax returns for the years 1991 and 1992.

Hatch faces up to 5 years of imprisonment or a fine of $250,000, or both, for each offense. He also faces substantial civil penalties and interest on any unpaid Federal tax liability.

According to the Information, **Hatch** was the President and sole shareholder of a waste hauling business in Sudbury, Massachusetts, which was known as H.H. Disposal, Inc.

The U.S. Attorney alleges that **Hatch** diverted certain business receipts from H.H. Disposal, Inc. and willfully failed to report those business receipts on the tax returns he filed with the Internal Revenue Service.

The Information charges that **Hatch** filed false U.S. Individual Income Tax Returns (Forms 1040) when he willfully understated his taxable incomes by approximately $14,407, in 1991, and approximately $45,335, in 1992.

The investigation was conducted by the Internal Revenue Service's Criminal Investigation Division. The prosecution is led by Assistant U.S. Attorney John M. Hodgens, Jr., of Stern's Economic Crimes Unit.

Press Contacts: Amy Rindskopf or Joy Fallon, (617) 223-9445

NEWS RELEASE

LINDA L. KELLY
UNITED STATES ATTORNEY
WESTERN DISTRICT OF PENNSYLVANIA

Suite 224, Penn Traffic Building • 319 Washington Street • Johnstown, PA 15901 • (814) 533-4547

United States Attorney Linda L. Kelly announced today (November 3, 1997), that a resident of Blair County, Pennsylvania, entered a plea of guilty in federal court in Johnstown to charges of bank fraud and filing a false income tax return.

Entering the plea before United States District Judge D. Brooks Smith was Charles H. Gault of Tipton, Pennsylvania.

According to information presented to the Court at the time of the plea by Assistant United States Attorney John J. Valkovci, Jr., from July 11, 1991 to August 5, 1996, Gault, an employee of Tammac Corporation, on approximately 400 different occasions withdrew approximately $454,260.93 from Tammac's loss reserve account at the United States National Bank. Gault represented to the bank that the withdrawn funds were to be used for business expenses at Tammac, when in fact, he converted the funds to his personal use.

Gault also pleaded guilty to filing a false federal income tax return for the calendar year 1995 wherein he failed to report the money he had taken.

A sentencing date has not yet been set by Judge Smith. Mr. Valkovci indicated that Gault faces a maximum sentence of 33 years imprisonment, fines totaling $125,000.00, or both. The actual sentence imposed depends upon the application of the Federal Sentencing Guidelines under which the Court takes into consideration the seriousness of the particular offense as well as the prior criminal history, if any, of a particular defendant.

This case was investigated by the Internal Revenue Service, Criminal Investigation Division, the United States Secret Service and the Federal Bureau of Investigation, Johnstown Resident Agency.

U. S. Department of Justice

United States Attorney

District of Massachusetts

1003 J.W. McCormack Post Office & Courthouse
Boston, MA 02109

October 16, 1997

PRESS RELEASE

TRUCKING COMPANY PRESIDENT SENTENCED TO JAIL FOR FILING FALSE TAX RETURNS

Boston, MA ... United States Attorney Donald K. Stern announced that **NICHOLAS FUSARO, JR.** has been sentenced to eight months in custody for filing false individual tax returns for the years 1990 and 1991. U.S. District Court Judge George A. O'Toole ordered that **FUSARO** serve four of the eight months in prison and four under house arrest while wearing an electronic monitoring bracelet. Judge O'Toole also fined **FUSARO** $20,000, the maximum fine permitted under the federal sentencing guidelines. **FUSARO** will also have to pay any and all back taxes, together with interest and penalties.

FUSARO, 37, resides at 15 Dakel Drive in Assonet, Massachusetts. He was the president and 100 percent shareholder of Fusaro Transportation, Inc., which was located in Assonet, Massachusetts. Fusaro Transportation, Inc. was a subchapter S corporation engaged in the trucking business. The company hauled, among other things, materials for the textile industry from the southern part of the United States to New England. Because it was a subchapter S corporation, its net income or loss flowed through to **FUSARO'S** personal income tax returns.

According to the evidence at trial, **FUSARO** took monies which were due and owing to the company and used them for his own purposes. By doing so, he caused his personal income tax returns (Forms 1040) to underreport income he earned and caused corporate income tax returns (Forms 1120S) filed by Fusaro Transportation, Inc. to underreport the gross receipts earned by the company. The court found at sentencing that FUSARO underreported over $180,000 in income on his 1990 and 1991 tax returns, which resulted in a tax loss of over $50,000.

Also, according to the evidence at trial, during the fiscal years ending September 1990 and September 1991, **FUSARO** caused Fusaro Transportation, Inc. to pay him monies which he deposited into his personal bank account and then claimed were tractor expenses.

FUSARO took for his personal use monies which were intended as payment for services rendered by Fusaro Transportation, Inc. and caused those payments not to be recorded on the books and records of Fusaro Transportation, Inc. This is a procedure commonly known as skimming. In calendar year 1990, FUSARO fabricated tractor expenses, and took monies from Fusaro Transportation, Inc. for his own use under the guise of reimbursements for business expenses, according to the indictment and the evidence at trial.

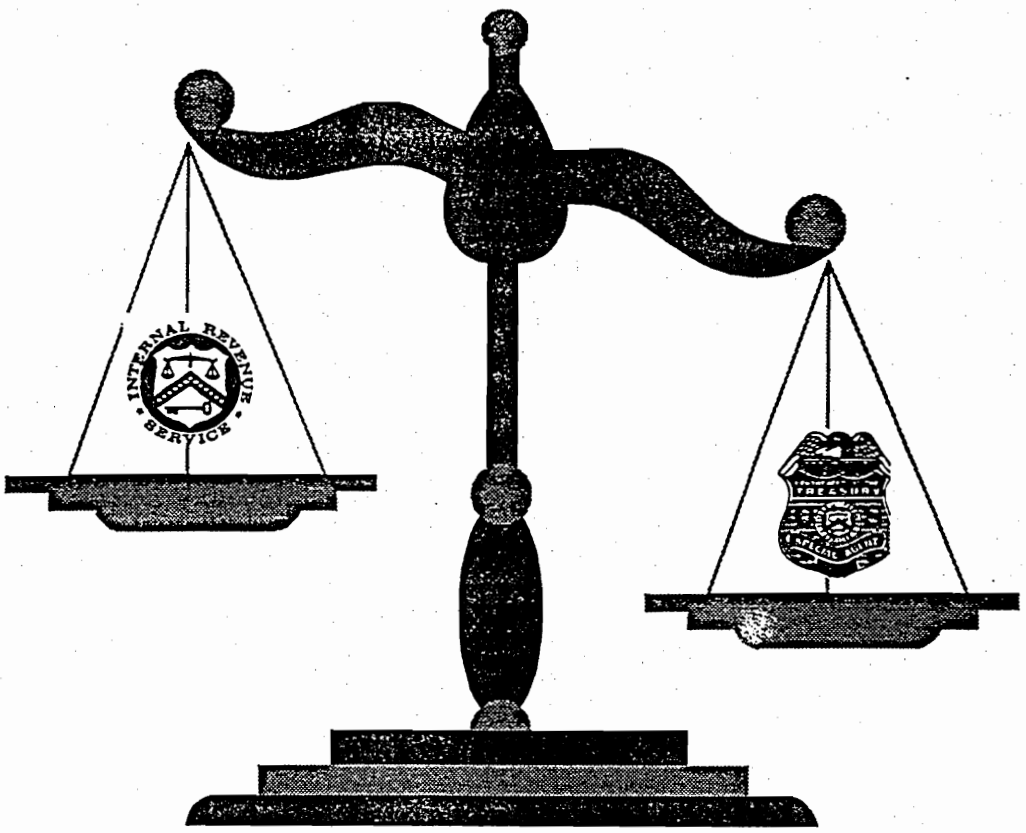
The case was investigated by the Internal Revenue Service, Criminal Investigation Division. It is being prosecuted by Assistant U.S. Attorney Stephen G. Huggard, of Stern's Economic Crimes Unit.

Press Contacts: Joy Fallon and Amy Rindskopf, (617) 223-9445

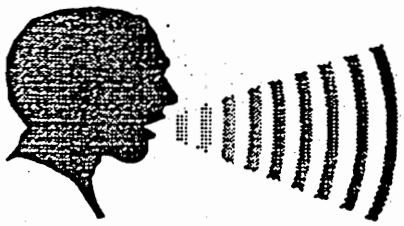
Appendix 2

Publicity Guidelines
IRS Criminal Investigation

[Extract]



"Credibility is destroyed when you speak with the media before you are prepared to address the issue at hand."



Criminal Investigation Mission

In support of the overall IRS mission, Criminal Investigation enforces the criminal statutes relative to tax administration and related financial crimes, in order to encourage and achieve, directly or indirectly, voluntary compliance with the Internal Revenue Laws.

INTRODUCTION

Why Should Criminal Investigation Activities be Publicized?

* One of the most effective methods to "encourage and achieve, directly or indirectly, **voluntary compliance** with the Internal Revenue Laws" is through the publicity of both notorious and "regular" individuals convicted of violating the laws and statutes within the jurisdiction of Criminal Investigation.

* Publicity of Criminal Investigation's mission and investigations results in favorable strategic organizational decisions relating to **funding, legislative actions and organizational support.**

* Publicity of Criminal Investigation's role and responsibility **positively impacts within the law enforcement community** on those individuals responsible for support and funding of law enforcement programs.

* Publicity of Criminal Investigation's activities serves as a **recruitment** initiative by casting a positive image on the job, organization and role in the law enforcement community.

* When Criminal Investigation agents work side-by-side with agents in other law enforcement agencies, publicity of Criminal Investigation's role in multi-agency investigations greatly **enhances the morale** of special agents by recognizing their contributions to combating crime.

How Will Criminal Investigation Achieve Publicity?

* Criminal Investigation will adhere to the organizational policies relating to **Internal Revenue Code Section 6103** disclosure provisions and will ensure that taxpayer information is safeguarded.

* Criminal Investigation will adhere to the **Privacy Act, 5 United States Code 552a** to ensure that taxpayer's rights are protected at all times.

* Criminal Investigation will become more proactive in their relationship with the media and in issuing press releases.

What, How and To Whom Do We Want to Communicate?

1. Who are our "public's"

    * IRS Executives
    * IRS co-workers
    * Subordinate employees
    * IRS Chief Counsel attorneys
    * Other law enforcement agencies
    * The US Attorney (and staff)
    * Department of Justice Attorneys
    * Informants
    * The American Taxpayer
    * The Media
    * Potential employees

2. What does Criminal Investigation want to communicate?

    * What we do, why we do it and our impact on these various "publics" as well as the American economy

3. How will Criminal Investigation accomplish this?

    * press releases
    * speeches
    * media interviews
    * articles in local news papers and magazines
    * community activity
    * editorial boards
    * PAO media contacts

PURPOSE OF THIS GUIDE

This guide has been developed as an aid in communicating the CI mission and activities to various publics.

FREEDOM OF INFORMATION ACT (FOIA)

Nothing contained herein is intended to control access to Internal Revenue Service records which are publicly available under provisions of the Freedom of Information Act (FOIA).

FINANCIAL INTERMEDIATION FOR THE POOR

SOUTH AFRICAN CASE STUDY

by

Nick Vink
Mohammad Karaan
Catherine Cross

A report to Development Alternatives Inc. in terms of the EAGER Project
Public Strategies for Growth and Equity Component (EAGER/PSGE)

September 1997

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1.2 The target population

The social cost of any intervention that aims to bring benefits to a section of a population consists of the costs of administration, the leakage of benefits to those not targeted by the programme, and the costs flowing from the changes in incentives facing both these groups. For example, a programme that aims to bring access to financial services to a well-defined target population will have higher costs of administration than a more loosely defined programme, and it will create incentive problems, especially for those groups who narrowly miss definition as part of the target population. On the other hand, there will be less leakage of benefits to the non-targeted population. Therefore, it is necessary to, at least conceptually, subject all such interventions to a benefit-cost analysis to find the appropriate balance. Simultaneously, it is necessary to subject all possible intervention agencies to a benefit-cost analysis to counter any bias in favour of intervention by the state.

The 'state of the art' paper that began this study identified the financial needs of the poor, based on international experience. These findings are corroborated by the South African experience, as will become evident in Chapter 2 below. Broadly stated, these needs are (Nelson, p. 5):

- ...regular access to adequate food. After food security, improved living standards, income generation and growth require the accumulation of productive assets, including 'human capital' in the form of health, education and training. Access ... to services is governed by income and by purchasing power, which includes the ability to shift income in time (from periods of income generation to periods of penury) and space (from migrants in urban areas or abroad to rural households) as part of a coping strategy. The ability of a household to cope ... depends upon, *in order of importance to the poor themselves*:

  - income generation, which for marginalised households and individuals depends in turn upon diversification of revenue sources;
  - savings and dissavings from that income, whether in cash or in kind;
  - transfers; and (as a last resort)
  - borrowing.

- The poorest of poor households ... may draw on diversified sources of revenue including transfers and dissaving (including selling off assets). Increasing household debt (the obverse side of the coin called 'credit') is a revenue option, but one not taken lightly by a household confronted by adversity, even when donor programs have attempted to lighten the repayment terms for that debt. Indeed, one of the major lessons of the past is that credit programmes have not addressed the needs of the poor, particularly the poorest of the poor. Improved financial intermediation involves providing instruments for stabilising the household's consumption with the least damage to its wealth and income. Constructive coping strategies including emigration, diversification of income sources, or pooling capital with others to start microenterprises. Destructive strategies include undertaking poorly paid off-farm labour out of desperation, charcoal production from gathered wood, skipping meals or less nutritious foods, cultivating marginal lands, emergency borrowing for non-productive purposes at high interest rates, prostitution, and sending children to beg rather than to school. Access to remittances may be key to raising the poorest households above the poverty line (World Bank, 1995). This financial framework is much broader than the concept of productive credit which led many donor activities in the past, which stressed income generation (and sometimes diversification) and borrowing, but which ignored savings and transfers.

This emphasis on liquidity is important. Access to liquidity prevents a setback from becoming a catastrophe either in terms of productive assets or in basic nutrition; the obverse of the coin is that it permits individuals and households to benefit from unforeseen opportunities to engage in profitable activities. The accumulation of such activities (or the avoidance of such catastrophes) leads to asset accumulation which permit productive investment and which provide the collateral for acquiring debt for productive purposes. As is well known from the literature on credit impact, finance is not a productive asset, it facilitates production

and investment. Thus, the provision of financial services to the poor is not a growth strategy, it supports such a strategy and the efforts of the poor themselves.

This study concentrates on the institutions (in the economic and social sense, not the bricks and mortar type) which function already to resist the mechanism(s) that worsen poverty and to strengthen the mechanism(s) that support nutrition, consumption smoothing and accumulation of productive assets. While many of these institutions exist for all social and economic classes, higher-income individuals and households have greater access to formal financial services, and this study will not deal with these except as they have an effect on the provision of access to financial services to poorer members of society. In examining the specific African country experiences, the research explores the importance of particular types of constraints, whether macroeconomic, regulatory, or institutional. While based on specific cases, the exercise will yield a checklist of issues for researchers and policy makers in other countries to use in developing a strategy to provide full financial intermediation for the poor.

1.3 The case of South Africa

Studies in comparative history[2] of this nature have to take into account the vagaries of each of the countries under consideration. In this sense there are at least two issues that need to be examined in some detail in order to provide context to the South African case. These relate to the geographic and demographic identification of the target clientele of a study of this nature; and to the peculiar institutional arrangements that exist to serve the needs of this clientele, and upon which any proposals will have to build.

First, in section 1 of Chapter 2 an attempt is made to define those people who do not at present have continuous and affordable access to the full array of services provided by the financial markets in South Africa, other than through intermittent transactions that link 'informal' and formal markets. This analysis points to a number of anomalies that exist, especially related to the weakness of the data base. More specifically, a review of all relevant sources of data and an examination of classification systems in use to identify the urban and rural distribution of the South African population shows that each source relied on the definitions of Central Statistical Services (CSS) for their basic classification. Until recently, however, CSS only made a simple distinction between urban and non-urban people as the base classification of the population.

The difference between 'urban' and 'non-urban' is whether an enumerated household lives within a formally declared township or not. This means that large numbers of people living in 'urban' conditions are defined as non-urban, such as many of those in the greater Durban metropolitan area that are the subject of one of the case studies in Chapter 3. In formal terms many of these people occupy land that falls under the jurisdiction of a traditional authority, i.e. it is tribally owned land. On the other hand, if these case studies had been replicated among people who are living in similar circumstances in the Gauteng or Western Cape provinces, they would in all likelihood have been classified as 'urban' purely because much of the land that they occupy happens to have been proclaimed as formal townships.

This difficulty is compounded by the situation in the former homeland areas. Some 47% of the population live in these areas, which make up some 14% of the surface area of the country. Yet official data show that only 3 of 104 magisterial districts are classified as 'urban', while more informed estimates, such as that of Graaff (1987)[3] show that, by the mid-1980s, at least 50% of the population lived in areas that are functionally urbanised.

The result is that any study of this nature will tend towards a rural bias if these official definitions of population categories are used. The reader is, therefore, cautioned to allow some flexibility in attempting to understand the particular plight of South Africa's poor and marginalised population.

---

[2] To use the phrase in the sense proposed by Johnston (e.g. 1995?)

[3] Graaff, Johan, 1987. ....

Second, any scholar of South Africa's modern history will recognise that the provision of financial services to the poor is similar to most other developmental problems that confront the state. Here, as elsewhere, the main problem that has to be addressed is the possibility of delivery in the presence of unsustainable institutions. These institutions, whether formal or informal, and whether public, private or non-governmental, are a product of the apartheid past. Any recommendations for remedial action have to take this factor into account. This problem of unsustainable institutions is prevalent along at least three dimensions of the development problem:

- There is ample evidence that financial markets operate through informal institutions in bringing a wide range of financial services to especially poor people in South Africa. The numerous case studies of such informal arrangements presented in Chapter 3 below add to the available evidence in this regard. However, past policies have a major impact on who uses these markets, and under what circumstances. They also determine the nature of links between formal and informal financial institutions. Further, while such informal arrangements may meet the immediate needs of the poor, they do not of themselves constitute a development strategy. The poor need access to other support services, and in terms of access to financial markets, the poor need more choices.

- The evidence presented in Chapter 2 below will show that most formal financial institutions in South Africa that try and provide banking services to the poor are unsuitable vehicles for this purpose. In summary, state and parastatal institutions are perpetually subsidy-dependent, private sector institutions provide only savings facilities, and NGO institutions lack sufficient outreach. International experience has shown, however, that it is possible to provide such services on a commercially sustainable basis. Any remedial recommendations have to take this institutional weakness into account.

- One of the main reasons for the institutional weakness of state and parastatal institutions described above is the dual bias in existing institutions towards lending to agriculture. International experience has shown that this bias weakens financial institutions in two ways. Lending to the poor creates problems of moral hazard, and a single-sector strategy creates problems of covariant risk. The case study on the agricultural banks in the Eastern Cape shows up the weakness of this strategy, and the kind of remedial actions that are being taken. As was noted, the private sector has only recently tried to devise mechanisms to circumvent these problems (one such attempt is included as the case study of the NewFarmers Company in Chapter 3), while NGOs have yet to prove that they can deliver at scale without repeating the mistakes of their counterparts in the public and private sector (this issue is also raised in the case study on the Village Banks in Chapter 3).

Finally, this report has drawn strongly on the analysis and conclusions of the Strauss Commission[4], as stated in the Terms of Reference for the study. This has the advantage of drawing on the most recent comprehensive analysis available, yet the disadvantage of inheriting some of the biases in that investigation. For this purpose, the case studies presented in Chapter 3 have been chosen in an attempt to address the bias towards the rural and agricultural activities of parastatal institutions. While two of the case studies have an agricultural background, there is also an analysis of private sector involvement, of the problems of a largely urban and peri-urban population, of the provision of other services such as transmission and savings instruments, and of the use of alternative lending technologies such as group approaches.

1.4 Study outline

The purpose of this introductory chapter has been to explain the origins and goals of the study, and to provide a perspective on the research that was undertaken, as well as the context within which the report has been set. In Chapter 2, the analyses that were used in the Strauss Commission report are summarised to provide some guidelines as to who 'the poor' in South Africa are, and what they need from the financial

[4] The *Commission of Inquiry into the Provision of Rural Financial Services*, appointed in 1995, produced an Interim Report (March) and a Final Report (September), whose recommendations were substantially accepted by the government.

services sector. This is followed by a description of the major policy initiatives that are being undertaken by the present government, with a focus on the effect on financial markets and on the way in which poor people engage in these markets.

Four case studies of this kind of interaction between the poor and the financial markets are presented in Chapter 3. These include cases taken from the initiatives of the parastatal, private and NGO sectors, as well as from informal financial markets. An attempt has been made to balance these cases studies with respect to geography, sector focus, clientele and financial instruments. Thus, while two of the case studies are on institutions that have focused exclusively on agriculture in the past, they also raise issues of alternative collateral instruments, of the possibility of using savings mobilisation, and of the use of venture capital as an alternative source of funding for the capital requirements of a land reform programme. The other cases cover the needs of people who are no longer as strongly tied to the rural economy, as well as the ways in which linkages can be forged between formal and informal institutions.

In Chapter 4 the legal and regulatory environment is described, with a focus on the ways in which it debilitates access by the poor to financial markets, whether formal or informal. In the South African circumstances, it is clear that any recommendations that aim to create the preconditions for successful banking for the poor will be dependent on legal and regulatory reform. This conclusion was reached by the Strauss Commission, and these legal and institutional disabilities remain as the major cause of weakness in existing institutions.

FINANCIAL INTERMEDIATION AND POVERTY IN SENEGAL

Hamet NDOUR and Aziz WANE

In the context of economic globalization with automated production and electronic finance, there remains a consensus that microfinance provides a plausible approach to addressing the pressing economic problems of the poor. The following study was performed by our company under the supervision of a research supervision committee of respected researchers and professionals in finance, microfinance and social advocacy.

The document consists of five sections: (1) identification and description of the poor in Senegal; (2) identifying the policy and regulatory regime which guides senegalese finances, with a goal of understand the elements which encourage or constrain finance for the poor; (3) attempting to understand the relation of decentralized financial systems to the uses and customs of the poor; (4) creating recommendations for a better system integrating the population at risk; and (5) based on the best-performing local experiments and experiences, proposing elements to improve and even to induce a better functioning of a more accessible and more viable system.

POVERTY IN SENEGAL

"In Senegal, 30 percent of households live below a poverty threshhold defined as the expenses required to provide 2,400 calories per day per person. 75 percent of poor households are rural, while the rural population is 60 percent of the total population. 58 percent of rural households are poor. (Ministry of Plan, p. 4)

The formal financial sector in Senegal is concentrated. Control of the financial system by a small number of banks with few branches excludes an important proportion of the population. The poor are the most affected by a system which requires long procedures for access and by their inability to provide guarantees and personal recommendations required by banks. This exclusion demonstrates the incompleteness of a system (in terms of financial institutions and products) in which the poor cannot find financial products compatible with their resource allocations (in space and in time) within the formal sector.

The choice of a measurement of poverty must be made in the spirit of the choice of anti-poverty strategy. Strategies which attempt to improve the revenue-building capacities of the poor and facilitate the finance of these capacities look at the wealth-building aspects of the struggle. This is a different approach from considering the subjective aspects of the sense of worth individuals draw from their situation in life. Household surveys are an important source of poverty data. Such a study was done in Senegal by the Direction de la Prévision et de la Statistique (DPS), a Study on Priorities (ESP). A more complete study (ESAM) followed up on this but has not yet been published. Several studies quantifying poverty have been based on ESP. Of the 837,000 rural households in Senegal, 720,000 are considered poor based on quality of habitat, while 275,000 of these have a nutritional deficit. These (420,000 rural and 300,000 urban) are natural candidates for micro- financial services (MFS). If each household has 3 adult members (surveys show the mean household is 8.5 persons) qualified to engage in financial services, the target population for microfinance structures is 2.16 million poor potential clients.

Strategies to reduce the severity of poverty (numbers of poor persons) should be directed toward the zones where hunger is greatest, the departments of Sédhiou, Dakar, Fatick, Kolda, Mbour, etc. Still, microfinance strategies oriented toward these zones will face high risks in the sense that food deficits often translate into low productivity and low relative costs or low penalties for violating contracts.

LEGAL AND REGULATORY REGIME

The fiscal and banking crisis of the 1980s affected most West African financial institutions and led, in Senegal, to the liquidation of problem banks, the withdrawal of the State from the banking sector and the establishment of a super-national supervision committee responsible for monitoring banking practices. The cleanup effort led to a new banking law with stronger protection of depositors, stronger competition, and support for informal finance. A technical assistance project for mutual banking (ATOBMS), in collaboration with the BCEAO, led to the "PARMEC" law establishing a program of assistance to the regulation of savings and credit cooperatives, which was adopted 5 January 1995.

However, despite all precautions taken to protect depositors, improve competition and direct informal finance, the system which was established does not correspond to the needs of the poorest, and hence has little or no impact on their financial behavior.

The Banking Law of 1990 applies to all banks and financial institutions, except the BCEAO, international institutions and foreign aid. It defines a "bank" as any entrprise which receives funds which it used for credit or investment, while "financial institutions" partake in lending, sale on credit, or foreign exchange, and/or receive funds which they invest. The bank or financial institutions must be pre-registered with the Ministry of Economy, Finance and Plan (MEFP) under the guidance of the Central Bank and after approval by the Banking Commission. The law requires that all banks and financial institutions take limited liability corporate form of organization. A bank must have "social capital" of CFAF 1 billion (US$1.5-2 million), versus CFAF 300 million (US$600,000) for a financial institution, and equity must be equal to or greater than the minimum social capital.

Exceptions may be made for banks or financial institutions under special law, islamic banks, and mutual or cooperative institutions created under special authorization of the MOF accorded after approval by the Central Bank. Finally, the law prohibits use of the term "bank" or "financial institution" in the name of any body not approved by the MOF and the Central Bank. Banks and financial institutions must submit annual financial statements to the BCEAO which publishes their annual balance sheet. The banking law sets prudential ratios which all must meet and which are followed closely by the Banking Commission, though at the moment most Senegalese financial institutions are not yet in compliance with medium- and long-term cover, so their application has been postponed.

The draft bank law is particularly strict in the concept of management instruments. However, in recognition of the current financial organization of several units, the authorities are interpreting this liberally.

Mutuals or cooperatives have the right to request bank status, once they meet the conditions and are authorized by the MOF, under the legal form of variable capital companies. The law permits flexibility and waiving of the application of prudential rules for these societies, which are not subject to banking regulations. But since this so-called intermediate status covers a great diversity of structures, a legal framework was developed to cover these diverse experiences. The 1995 PARMEC law and its application decree address groups and other non-mutual financial structures.

The law does not discriminate between savings and credit cooperatives and their unions and federations, but *in principle* it is open to savings and credit groups which are not recognized as individuals under law, subject to reconnaissance by the MOF. The draft application decree discusses non-mutualist organizations which engage in savings and credit. However, in application these are restricted generally to NGOs or development projects, not to informal organizations. The decree also specifies the

conditions for operation in the authorized activities, forms of legal recognition, rules of functioning and means of public control. The law gives many advantages: current activities are made legal, organizations are accorded moral personality in law, the organizational name and functions are protected, and cooperatives are granted tax-free status, among other advantages.

The MOF is given responsibility for authorizing or retracting authorization from such organizations, for inspection and control, and for assuring they comply with financial rules. The Ministry must be informed of all modifications in bylaws, of dissolution, and receive financial reports and annual reports. For their part, the Central Bank and the Banking Commission must give their agreement on management and control procedures.

This is a *dirigiste* system in which local bodies must refer to national banking law regarding interest rate ceilings determined. by the usury law. The credit to any member cannot exceed 10 percent of total deposits; stable resources must exceed medium- and long-term credits and liquid and short-term assets must never fall below 80 percent of callable assets plus short-term credit.

THE FINANCIAL NETWORK OF THE DISADVANTAGED

Mutual savings and credit structures and non-mutualist financial systems are the principle sources of microfinancial services in Senegal. The introduction of non-centralized mutual financial systems (MFS) in Senegal dates from the mid-1980s and corresponds to a flourishing of credit unions operating in parallel with traditional financial structures. A 1996 study "Diagnosis of finance in the rural world" identified around 91 promoters of MFS who had created 262 base units (excluding women's organizations) for savings and credit. These decentralized financial institutions represent a variety of credit/savings experiences: implementation technique, staff, and finance; objectives and philosophy; and size and degree of structure.

These organizations are based on Western cooperative principles: groups of people, non-profit, motivated by solidarity and mutual assistance. Whether they are legally recognized entities, their establishment principles are providing financial services exclusively for their members. Savings mobilization is the basic principle, upon which credit can be given to members for any purpose, consumption or production. The security of the loan depends upon the solidarity of the group. However, we should distinguish voluntary savings systems from those based on compulsory contributions.

Voluntary savings systems generally are established as credit unions under the umbrella of the 1995 law. The networks supported by donors include 61 institutions nationwide, of which the most important are Crédit Mutuel Sénégalais (CMS), Alliance de Crédit et d'Epargne pour la Production (ACEP), and the Programme d'Appui aux Mutuelles d'Epargne et de Crédit au Sénégal (PAMECAS). Some of these have special clientele (ACEP for micro-businesses), require liquid forms of security, and offer secure savings services. They are established by and for wage-earners, and poorly established in villages. At the other extreme, systems created by local initiatives with little or no external support generally have no formal accounting systems, a weak system of savings security, a strong presence in villages but a weak technical and financial support network. The CRECIS network is a notable example of this. In 1996 few of either type of network had received Ministerial authorization, but according to MOF publications this trend has been reversed.

At core, these institutions charge lending rates of 13-24 percent, which pay no attention to the usury rate defined by the monetary authorities. Savers receive 4-6 percent on deposits. The interest rate differential, however, is rarely enough for financial autonomy and sustainability. And while they offer

services to their members, they do not respond to the needs of the disadvantaged who lack access to them.

Forced savings systems are widespread and affect a large population. These flexible systems require no special system of management or financial control because all members make the same regular contribution. Some require labor contributions for collective farming or herding activities. The contribution size may vary by month. The general scale is contributions in the CFAF 50-1,000 range, and sometimes more. This is an old practice, but one supported by several donors. Credit may be expensive but to the benefit of the group's own members. Generally the total resources are insufficient for declared demand for credit and the volume of financing overall is relatively small. Savings are illiquid and no services are provided to non-members. However, this fills an important niche in savings and in developing a personal capacity to service debt.

Non-mutualist/cooperative systems focus on credit, not on institutional sustainability. The banking law prohibits donor projects and NGOs, the principal participants in such systems, from legal deposit mobilization. Therefore the objective of such systems is providing productive credit to a target population. We distinguish credit projects from non-credit projects with a credit component.

Credit projects stress credit which, when implemented, may create the capacity for saving. The emphasis is on borrowers' needs as determined by the project, and performance measured according to number of loans made and changes in employment, income, etc. Problems including repayment rates and high intermediation cost are, in this context, considered secondary to the achievement of the project's goal, as are the viability of the borrower's activity and the financial health of the system. These institutions are the result of cooperation between the Government of Senegal and donors who work through NGOs and include Conseil et Partenariat Entreprise (COPARE, Saint Louis); National Association of Maisons Familiales Rurales (Thiès) ; Sénégalo-Swiss Counterpart Fund; the Projet PME (SME) (Thiès); and the SME Development Assistance Project (Dakar).

In **projects with credit components**, credit supports the principal activity of the project. The partisans of this approach argue that "credit creates the means for saving". Some attempt to create their own networks (the FDEA offices), others develop partnerships with existing systems (the PMR and CMS assisting the Women's Group Movement in Thiès) or with banks (PAPEC with CNCAS for artisanal fisheries, PAPEL with CNCAS for livestock). Despite a diversity of goals, of target groups, of forms of organization and operation, the financial conditions and the scale of interventions are aimed at development (improving the standard of living of target groups, generating income-producing activities, etc.), education/training (sometimes a secondary objective), or financial services (resource mobilization or credit) to the most disadvantaged outside the banking system. However, these all rely on heavy subsidization particularly of operating costs but also on the interest rate charged on loans. Loan targeting by these systems has the side effect of damaging the functioning of real markets, and harms competing systems based on quality, viability and accessibility to the poorest populations.

Informal financial practices have always existed in Africa. They include mutual assistance and financial solidarity systems such as *tontines* (ROSCAs) which take a diversity of forms such as *ndawtal*, *nate*, or *fôte* in Senegal, or *diagokoun* or *manankoun* in Mali. The also include private profit-seeking initiatives which lend in this environment by using social links or pawns to control risk. Other systems which accord with local values offer savings mobilization to cover social and economic needs, such as money keepers and supplier credit.

The spread of microfinance programs is highly correlated with the growth of the urban informal sector

and rural technology, which increase the spread between economic growth and the deterioration of the socio-economic situation of many which leads to budgetary problems beyond the ability of deteriorating social relations to address. In this milieu is growing an informal financial system which is organized and controlled by the informal sector. The financial products and services of the modern sector have their counterpart in the informal sector, from foreign exchange to credit, from savings to transfers.

Traditional credit comes from diverse sources under diverse conditions: from relatives, friends, money keepers, shopkeepers, *tontines*. It can be free, or based on interest rates at varying degrees of extremity. An extreme case we found at Dagana, called *thieub-thieub*, charges 40-50 percent per day. While this appears unimaginable as an annualized rate, it is accepted by both parties. Borrowers trade in foreign exchange with Mauritania at a substantial trading margin. The same practice is found in urban markets where women borrow under the same conditions to engage in transactions which yield them a net profit at day's end.

Transfers are important to the poor, who use transporters, travellers or shopkeepers, with the security of the transaction assured by solidarity and social ties among sub-groups. Even international transfers are common using the "Banque de Sandaga" (the principal market in Dakar) which in addition offers a foreign exchange service which is more rapid and provides better exchange rates than do the commercial banks. A leading banker testified to us that "if I have an urgent but unexpected trip, I change money at the Sandaga market". The Minister of Finance, questioned at a workshop, replied "...since my birth there has been banking practiced at Sandaga. Do not look to me to make it disappear ...".

The poor save. For the 363 local units identified in the 1996 study, the total net savings over a five-year period came to CFAF 9.54 billion (US$14-15 million). Comparing this to the number of participants enumerated (79,590), average net saving for the poorest rural populations is around CFAF 23,000 ($35-40) per year. For many, this is a nest-egg for inevitable "lean" periods to come. Senegalese employ particular forms for this saving, including customary saving (ruminants, jewelry), labor investment (family or village group "forced" group labor activities), cereal stocks (family silos or group warehouses), investment in family members, and tontine savings. These traditional forms are in harmony with the realities and needs of poor populations. But in whatever form, they still have certain inadequacies and follow rules which keep them small in scale and are not amenable to growth.

Sustainability of local financial units is essential for them to provide services to the disadvantaged. This is tied to the efficiency of their operations, i.e. the minimum costs they require to function as a body. The sources of cost include the cost of headquarters, and include administrative and salary costs. These salary are closely tied to their capacity to become self-sufficient. According to Jacob Yaron's measure described in the SOAP the Index of Subsidy Dependence, two of the bigger programs in Senegal are not yet self-sufficient. Our study calculates the subsidy per franc loaned at CMS is 36.7 percent, and at ACEP 29,5 percent. This is not credit subsidy, but institutional subsidy. If these institutions could maintain their salary amount and increase scale this would disappear, but CMS is not doing this and ACEP requires highly trained and well paid office staff. Using this model and the number of current clients of the two organizations, to do an average size loan to each of the 275,000 poor households of Senegal would require US$236 million and a subsidy of $73.3 million. Current approaches are not sustainable!

To elucidate the financial practices of the disadvantages, the team presents two case studies.

Case 1: **Djénaba Ly** is 52 years old. She is the first of four wives of a 70-year-old who because of age and bad eyesight no longer works. She has seven children and is responsible for three grandchildren who

live with her in the family concession in Pendao village. As first wife, she is responsible for assuring the primary needs of the family.

"I share a collective field of one hectare with 99 other women of the village [each woman cultivating one are] where I grow paddy. Besides this, I do shoulder-season vegetable gardening on a family garden I cultivate with my co-wives. And, like all women, in dry season I do petty commerce in basic goods. The income from agriculture doesn't cover the family's needs, so we have just enough to eat during some times. It's especially the money my children send me which allows me to do the petty commerce and have liquidity during the dry season."

The agricultural season is financed by the funds in their tontine and by inputs supplied on credit. Other activities are financed by her own means, essentially the money sent by her children from time to time. Recently a credit union was established in the village; it provides loans to purchase inputs on better and cheaper conditions, and finances other non-agricultural activities. Before then she frequently used the services of Djiby, a village shopkeeper friend of her brother. "Djiby advanced me goods on credit which I resold in the markets of the nearby villages."

Transfers: "I pray the good lord to look down on my children whose support to me is incalculable. I understand it is difficult where they are. But that doesn't prevent them from regularly coming to my aid. Originally they sent money orders by the post office or through travelers or transporters. Since then they have arranged with their friend Djiby who gives me money or merchandise.

Savings: (1) a silo to stock grain in anticipation of the lean period before the harvest. (2) Each time she receives money from her children, she buys a lamb or a kid to raise. (3) The credit union requires its members to save to qualify for credit. Last but not least, (4) their tontine is organized such that each woman contributes 500 francs per month. At each drawing, however, the winner receives only half the pot; the balance is maintained in a common account for use in emergency and to finance the agricultural season.

Case No. 2: **Mbathio Niang** lives in Thiaroye on the sea. She is 50 years old, her husband is retired, she has five minor children and is responsible for five others. Born of poor parents, she has never been to school and began work at the age of 15, aiding her mother-in-law to preserve fish in the bay of Thiaroye. During seven years she worked as descaler, washer, drier, seller, and other tasks. During this time she gave part of her earnings to her uncle, her friend and confident. Mbathio was shocked one day when, after 3 years of saving, her uncle claimed that she had never given him money. Besides this shock, her mother-in-law was angry because Mbathio had not had confidence in her instead. Afterward, Mbathio confided her funds in her mother-in-law. After the seventh year of "apprenticeship", the mother-in-law retired, donating to Mbathio her simple tools and returning all the savings (70,000 francs) confided in her. Thus Mbathio started her own business in which her own savings providing the working capital.

In her workplace there has always been a solidarity group (Penthioum Senegal) among the 200 women who do fish processing on that beach. Ties of solidarity and mutual assistance define the group. When it was proposed that the group receive outside finance, some accepted but others refused, doubting the motives of the donor. The group split in two, with a new group "Bokk Diom" the one which accepted the funding (the loan has been totally reimbursed). Today Penthioum Senegal is divided into 12 subgroups of which Mbathio's includes 17 members. This group has been aided by FDEA, ADPES and FENAGIE providing credit- plus-training but also by PROPECHE which is a credit-only institution.

"In the past, we worked only with PAPEC. The conditions were difficult for us: for 5,000 francs

borrowed we had to repay 5,500 francs. Each worker received 125,000 francs and reimbursed 33,000 francs per month for five months. For each installment we had to go to the bank in Dakar, and for security we had to take a taxi which cost 1,500 francs. Later the bank proposed that we pay at Yarakh, which cost us only 800 francs in taxi fare. We also received financing from ADPES, with each of us receiving 50,000 francs which we paid over 15 months with 4 months' grace period. However, we preferred to begin reimbursing the loan starting with the second month. At the end ADPES returned 600,000 francs to our group [for timely and complete payment by all members]. ADPES came to the village to collect each installment.

"Today many projects approach us and offer us credit. We don't always want that. That's also why we don't touch our money in our account at FDEA." A colleague adds "We're afraid of credit. We can't always repay."

Savings: After the incident with her uncle, Mbathio pays close attention to the security of her money. She participates in a tontine at her place of work and another in her neighborhood. In the first tontine she is treasurer. They are 100 women, each of whom contributes 200 francs per day with a drawing every five days. In the neighborhood tontine, 40 women each contribute 1000 francs per month with a drawing at the end of each month. Mbathio's husband has been unemployed for more than ten years. "To keep my husband occupied, but also so he doesn't start thinking about adding another wife, I bought sheep which I give him to guard. That's another safe way to keep my money."

Bokk Diom, the Group to which Mbatio belongs, has a savings account at the FDEA and another at CNCAS.

THE LEGISLATIVE ENVIRONMENT AND SYSTEM FUNCTIONING

Financial intermediation which takes account of the needs of the poor requires an appropriate legal and regulatory framework which takes into account the uniqueness of this population. It requires a favorable macroeconomic framework and presupposes that policy measures are not causing severe economic distortions. The institutions must be viable and accessible.

The banking system has been cured. The financial sector adjustment program had as its aim both protecting depositors and increasing competition among banks. This is the motive for prohibiting interbank agreements or protocols. Banks are required to notify the public of their rates and commissions by publishing in a legal journal and posting these figures in branches. This has turned around the banking sector, and liquidity has returned to the system. Private savings has grown by 95 percent from 1993 to 1995. In 1995, almost CFAF 345 billion flowed into the banking system and the short-term cover ratio rose to 101 percent.

However, this recovery is not seen in increased financing to the private sector. The investment recovery sought by the Central Bank when it reduced its discount rate from 14.5 percent in 1994 to 6 percent in 1997 failed to provide an incentive for investment. Worse, it served as a ceiling on the lending interest rate, since the usury rate is defined at twice the discount rate, and thus compressed interest rate margins. Banks have little interest in lending under these conditions and have lost credibility. Credit to the economy fell 16.5 percent from 1993 levels, and short-term credit has fallen over 50 percent. The structure of lending shows that between 1993 and 1994 the risk coverage ratio from 78.8 percent to 115.2 percent, primarily due to contraction in finance for agricultural marketing (CFAF 12.7 billion in 1994 but 441.5 million in 1995). Compared to other businesses, "banks appear responsive to the risk-reward tradeoff and are reacting rationally as the ratio has changed. For a given level of risk they will invest more if the expected profit increases, and this is not unrelated to their reallocation of funds between the

money market and productive lending." (Diery Seck in CREA). The increased selectiveness harms small enterprises and the poor who are not known to the banks.

Banking regulation and the new requirements affect the introduction of new financial products and services. Such innovation is limited in the law, and the new requirements are not necessarily compatible with the development of intermediation which serves the poor.

- The new openness does not extend to private sector provision of micro-finance. To be recognized by the State, one must either be a bank (CFAF 1 billion in capital) or a financial establishment (CFAF 300 million), or be a cooperative or donor/NGO project. The law is strict on this, to the point where even recognizing ROSCAs does not provide legal recognition. This reduces the possibilities for intervention.

- Mutual or cooperative structures with their collective and democratic principles and their non-profit goals thereby lack internal incentives to improve productivity or viability.

- NGO and donor projects, notwithstanding their only temporary authorization to function outside the cooperative framework, seldom are motivated to make sustainable and permanent institutions or interventions which are accessible to a wider public than their particular target populations.

- The openness provided in Article 6 of the Law would be improved if it were interpreted to acknowledge all local practices. In this interpretation, only non-recognition would be subject to notification. The option chosen instead serves to destroy the dynamics of successful local financial institutions in forcing them to assume an organizational model (credit unions) which is not necessarily adapted to the realities of the different milieux of the disadvantaged.

- The government, in its macroeconomic policy coordination with the monetary authorities, is attempting to encourage investment by keeping interest rates low. This choice favors capital-intensive investments at the expense of labor-intensive ones, investments with low productivity, and an unhealthy debt/equity ratio.

- Since the interest rate is limited by the usury rate which in turn is indexed to the discount rate, the risk/reward calculation of the banks discourages private sector lending. Second, the current level of the discount rate (6 percent) limits the possibility for decentralized units to undertake lending with small loan sizes or high supervision costs. Last the variations in the usury rate as the Central Bank has modified the discount rate 12 times in 4 years require difficult and costly portfolio adjustment measures for all banks, but especially for financially unsophisticated decentralized systems.

- Problems with the public sector include its unwillingness to respect its contracts, and the slowness of judicial procedures particularly in the case of problem loans. "We must respect the rights of lenders in order to decrease their transactions costs. That could affect how they deal with the risks related to transactions with the poor." (Fodé Ndiaye, *Finance et développement rural au Sénégal*, in CREA).

Access to real estate title is a related unsolved problem. To transfer the property they use through usufruct to the poor could increase their collatoral and encourage banks to increase lending.

Experience does not give confidence in reliance on the mutualist financial development model. "You can see the proof in the different unfortunate experiences of credit unions, NGOs and development societies which have made the population wary of the idea of creating credit unions, or led them even to consider the credit to be a subsidy and that credit should precede savings." (Diery Seck)

The senegalese financial environment consists of banking, decentralized and informal systems which coexist without articulation among them. A few partnerships should be mentioned, keeping in mind that most are still to young for us to claim their results as models.

The traditional system is based on local initiative and is adapted to the realities of the people. It is simple to operate, inexpensive and does not require specialized managerial skills. However we should not overemphasize its value. The case study of Mbathio shows that solidarity and social ties do not assure deposit security.

Tontines have a very limited impact because of the limits on their investment choices, to investments by their members, short-term in nature. The decentralized system has young institutions which are still seeking a path. Even if some are growing rapidly under donor support and with a defined strategy for achieving sustainability, most are guided by donors not greatly concerned with their financial and structural viability. Many of these structures require expatriate technicians to function. Most have not developed effective policies for deposit mobilization, and thus are not seen as viable by the banks which are necessary to enlarge financial flows. Having said this, there are some "success stories" which can be drawn upon to see how to improve sustainability and accessibility.

"Village Banks." Catholic Relief Services has since 1989 created a rural system based on the FINCA banking model. CRS donates funds to a local NGO, the "Entente" which lends the funds to Village Banks together with providing management training and supervision. Once in place and trained, the Village Banks are relatively autonomous. The Entente is responsible for training and supervising the management committee of each bank and supervising their finances and allocation of loans. All documents are kept in the village by the bank's secretary. During monthly meetings, the management committee receives and registers savings contributions by members and disburses loans to both members and non-members according to the funding collected. The structure is strongly decentralized with most decisions and management at the village level.

The objectives are financial ones: develop savings to accumulate and support personal wealth and utilize credit as a means to grow this wealth. They are also social, since the community participates in the management of this tool to wealth.

After 3-1/2 years of operation, each village bank has accumulated the savings and the experience to operate with no further outside assistance. The final objective of CRS is to develop an umbrella organization which can link these alternative financial institutions to commercial banks in both directions, credit and borrowing.

Members save a fixed amount per month at monthly meetings during the 6-month cycle which is based on lending. All borrowers must be savers; no interest is paid on savings. Anyone is free to withdraw his (or usually, her) savings at the end of each cycle but cannot remain a member in this case.

The six-month lending cycle begins in July and January, dates chosen because in the rural economy these are neither the best nor the worst months and thus encourage realizable levels of lending or saving for productive uses. Of the three types of loan, some are available to all and others only to members. (1) Loans based on external funding are awarded for 6 months at an interest rate of 15 percent per cycle, or 30-32 percent annualized. The first loan is capped at CFAF 15,000 but may rise to 150,000 by the 7th cycle based on good experience. Interest and principle are due in one installment on the due date. The Bank "profits" by the margin between the rate charged by the Entente (8 percent) and the loan rate (15 percent). (2) Loans based on the "first internal account" (the retained earnings plus the new savings

contributions of members in any given month) can be loaned to members or non-members at a rate of 10 percent per month. (3) Loans based on the "second internal account" (cumulative member savings) can be invested in one of two ways: part deposited in a commercial bank, and the other loaned (to members or non-members) at 25 percent interest for a period of five months. The average return is 27 percent per cycle or 54-61 percent annualized. Most applicants receive loans, many requesting a smaller amount than they are permitted to borrow. There is no special criterion for credit to non-members beyond personal reputation and risk of social sanction for nonpayment; the system depends upon mutual solidarity. However, in case of default the bank has the right to seize goods and sell them to reimburse the loan through their sale.

While the greatest impact is on the members (most groups are exclusively women), non-members can benefit from loans. Our study of the bank in Nganda, an isolated rural region, suggests that most members have very low incomes. In Nganda the average loan was for CFAF 33,800 ($67) which is (for reference) 15 percent of Senegal's GDP/capita. Part of the lending— the monthly loans from the first internal account— is available all year. This simple system allows non-members and members to receive credit with a simple request, to respond to opportunities for investments or family needs at that moment. The other loans are only available at the beginning of each six-month cycle.

Viability: Between July and December 1994, income income for 12 banks within the Nganda Entente covered 160 percent of their operating costs and 123% of the total costs (operations plus financial costs), before inflation. These are profitable institutions. This is due to the high interest rates and low operating costs. The fact that they combine member saving with debt to the Entente improves their profitability during the initial 3.5 years (the ratio of loans to savings varies between 4.0 in July and 2.5 in December according to the structure). The banks should become more profitable as portfolio size grows (from repeat borrowers qualifying for larger loans and from a growing pool of savings to lend)

Viability is further enhanced by the partnership Donor/NGO/Entente, which contains four key elements. First, commercial banks can replace donors in this relation to provide funds safely for credit to the disadvantaged. Shopkeepers or other private sector investors can also fulfill this role, except that the current law prohibits them from so doing! Second, this strategy uses group strength — organization of borrowers in groups to provide solidarity and mutual guarantee of recovery. Generally, the poorer the borrower the more effective this means of organization and the better it is adapted to their culture and needs. Third, the local NGO is using its comparative advantage over banks based on its proximity to the poor, confidence, engagement, flexibility and fast reaction time. To the extent that competent NGOs exist, they have a vital role as bankable financial intermediaries between banks and groups, or as nonfinancial intermediaries to identify, create and train groups. Next, this approach recognizes the importance of lending to the disadvantaged on a commercially viable and sustainable plan and base. Finally, NGOs can be replaced in this model by an appropriate for-profit private sector of relatively small scale.

Procedures: Alliance de Crédit et d 'Epargne pour la Production (ACEP) Performance criteria for including ACEP (despite its high subsidy dependence, described below) are its management and its credit supervision. Created in 1985 as a USAID-supported credit project, the 1993 disengagement of its donor required it to seek a sustainable legal status, a savings and credit cooperative for lack of any alternative under the existing legislation.

Unlike mutuals, the elected members of ACEP management are volunteers, while the technical and administrative personnel are salaried. Branch directors also receive a commission of 5 percent on the branch's profitability. Branches supervise loans and report regularly on the client's business. Through

such close supervision the repayment rate is around 99 percent. ACEP is well known as the best-managed and best-performing financial institution. It's secret is deft combining of principles of mutuality with banking rigor at the level of management. Additionally, the staff is well trained and the staff is rewarded according to results. Although ACEP benefits from subsidies, these are institutional subsidies rather than interest rate subsidies, and are falling over time. The 1996 (15-month fiscal year) profit was CFAF 510.7 million.

Savings and Transfers: the Post Office Financial Services. The *Caisse Nationale d'Epargne* (CNE) and the *Centre Cheques Postaux* (CCP) are two structures within the Senegalese post office. Their principal function is to collect and mobilize domestic savings for development. To do this they use the standard postal network consisting of 130 offices and two agencies. The law prohibits them from giving credit [for which they are ill-suited anyway].

With a deposit interest rate of 4.5 percent the CNE offers the highest interest rate on the market to its 225,000 account holders (31/12/96). It is simple to open an account, with a minimum 5,000 franc deposit and an identity card; subsequent deposits have no lower limit, encouraging small savers. Previously, the CCP network was strongly centralized and extremely slow, as to send or receive a transfer one had to open an account, the transfer traveled by post and was registered at the central bureau in Dakar. This has been replaced by use of fax and telex. Since 1998 the CNE system localizes accounts, allowing each account holder to hold the account in the post office of choice.

Also under the old system, all funds collected were held in the public Treasury. When Senegal had fiscal problems, savers had problems accessing their funds. Following the restructuring of the banking sector, the Post Office is no longer tied to the Treasury and can place its funds on the money market. Further, it has adapted a system of cash reserves to support withdrawals at the level of each office.

Among its innovations, the CNE has introduced new products which are unavailable elsewhere, including a retirement access account created in collaboration with the national insurance company CSAR. The transfer service is available to all residents of Senegal without preconditions and without cost to the recipient except for certain international transfers. Transfers can be paid in any post office where one has an account. The system is being computerized, electronic transfers are being developed, and negotiations underway with Western Union will improve international transfers. This has created an important market for the postal system including, in 1996, a contract with the French retirement accounts to serve as paying agent for all French retirement pensions received by people resident in Senegal. With a highly-performing system and a dense network, the CNE has received most of the business of overseas migrants repatriating their savings.

HOW TO IMPROVE FINANCIAL SERVICES

Institutional framework

Competition: Intermediation which favors the poor requires a competitive environment (horizontal among institutions of the same type, vertical among institutions of slightly different scale and specialization). This requires a variety of diverse organizations with clearly defined rules of operation. This is far from the current situation in Senegal where zones of strong concentration are juxtaposed with zones deserted by the financial sector.

Each of the 13,000 villages in Senegal has at least one economic operator offering financial services to the population and serving as intermediary between village and town. Improved systems for the poor

would open the financial profession by integrating this practice (often considered "usury") in the institutional and regulatory framework, giving it the same legal recognition of existance as mutuals and projects, to facilitate interaction banks. On the other side, banks should be free to create institutions which can intervene at different levels to create competition and improve the quality of products and services offered to these populations.

But if competition requires several competitors, it also requires a healthy framework in which contracts are respected, judicial procedures made transparent and accessible, and the rule of law prevails.

Developing interest in financial transactions with the poor: This study has shown that in rural areas and among the poor, credit interest rates lie largely outside the permitted range. In extreme cases they have reached 50 percent per day in cases where the profitability of the activity financed permits to repay the credit to mutual advantage. The lesson is that the interest rate per se is not the inhibiting factor. Also, where the volume of finance is low or payment short, interest *rates* do not play a determining role. However, such high interest rates may be what attracts financial institutions and justifies providing financial services for the poor.

In the current context of disintermediation in parallel with the regional stock exchange and access to the money market drawing corporations out of the bank finance market, the interest rate charged by commercial banks is not the primary constraint to increased investment. Non-interference by the macroeconomic policy makers in market equilibrium would improve the risk/reward ratio to improve financing for a large number of SMEs and strengthen investment. That is, it would reverse the bias against micro finance. Such steps include abolishing the current usury rate, at least for microfinance.

However, the current oligopolistic system of finance may not lower interest rates from banks. Evidence from mutualist systems including in neighboring countries is that the member/owners of these institutions are prepared to have high interest rates which benefit their own institution and help assure its sustainability. Higher interest rates would reduce bank use of the money market for placing excess funds, not necessarily for the direct benefit of the poor but to the benefit of the "bankable" institutions which retail financial services to the poor, at an interest rate compatible with the risk and supervision costs. This would also improve savings mobilization and dynamize the system. It would require banks to regard closely the efficiency of their operations to optimize procedures, lower structural costs and finally, serve to reduce the basic bank interest rate.

Today the average interest rate in decentralized finance is around 18 percent per annum. ACEP which, according to experts is the best-managed institution, manages to reach equilibrium at a rate of 15 percent. However, ACEP does not intervene at the level of the poor, because of the costs associated with such intermediation. Liberalization of rates for small institutions would permit the most efficient and productive to become accessible and viable, and to develop without subsidy.

Viable rural markets: Access to the rural poor to finance can be improved by a viable primary market in which operators can have positive and growing margins. These require non-financial investments in irrigation, commercialization and others to improve competition and production. It also requires reform of land tenure, at least so farmers can offer collateral for bank lending.

Institutional functioning

Institutions must become efficient, and this requires local deposit or savings mobilization and the possibility to engage in profitable off-balance-sheet activities.

Efficiency of financial structures in difficult areas requires partnership structures which reduce the cost of intermediation. A study in India (Puhazhendhi, 1995) compared banks' transaction cost for providing credit to the poor and found that NGOs and forced-savings groups reduce greatly the cost of intermediation. Using these intermediaries improves the financial viability of lending to these groups.

Skills are required to improve efficiency. A competent personnel, motivated, well trained, and with stable employment helps develop a loyal clientele and a demand for repeat services. This is not just more loans and better repayment, it is direct contact with clients. For credit unions, it requires greater training of the officers to improve their control.

Methodologies: Simple and flexible products responding to the needs of the group and to local conditions. This argues against all targeting programs which can bias the production environment.

Savings-based approaches are behind most solid and durable rural financial systems. Deposits by their nature permit liquidity and give potential lenders an inexpensive view of repayment capability. They reduce the net financial needs of borrowers. They impose a discipline on the lender. They change the image among the public of the purpose for the existance of the institution, and thereby affect loan recovery.

Off-balance sheet niche services include services which benefit the members of rural financial units. However, the banking law as part of its legislative and regulatory framework, prohibits financial institutions including small rural ones from engaging in such activities beyond 5 percent of their funds at risk unless authorized by the Minister. This limits educational programs, all programs which may increase the economic and social return to the project. Revising this condition for these intermediate institutions would improve the impact of decentralized institutions.

FISCAL POLICY IN SUB-SAHARAN AFRICA : A FRESH OUTLOOK ON THE ROLE OF EXCISE TAX

Case study : Madagascar

The main results of an statistical econometric analysis

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January 1998

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I-CALCULATING BUOYANCY AND EXCISE DUTY ELASTICITY

One of the assumptions of this project is that the "revenue from excise duties can and ought to double in most African countries". It is in this perspective that the "tax buoyancy" and excise duty elasticity in Madagascar have been calculated below.

Calculating the buoyancy of the total excise duty revenue

By calculating the global elasticity of the total tax revenue in relation to the GDP using the simple linear regression method for the period 1978 to 1996 and the "least ordinary square or los" computation method :

GDP=Gross domestic product in billions of FMG,
TR= tax revenue minus donations in billions of FMG
Year= Year in review

Log (GDP) = 144,88 + 0,0746*Year R2=0.98

Log (TR) = 118,74 + 0,0614*Year R2=0,95

Period = 1978-1996

Global elasticity (B) is therefore : B=0,0614/0,0746=0,823=82.3%

Since O<B<= 1, the tax revenue elasticity at the level of economic growth indicated by the GDP is almost inelastic throughout.

By replacing total tax revenues with excise duties revenue only(ER), computation using the same method of the model linking the variable "excise duty" in relation to time and for the same period yields :

Log (ER) = - 247,7 + 0,1265*year R2=0,90

The new value of B becomes 0,1265/00,0746 = 1,695 = 169,5 % and one notices that B = 169,5% is higher than 1, therefore the elasticity of excise duties revenue is generally elastic. It seems therefore that the "buoyancy of ER" (1,695) is higher than the "buoyancy of TR" (0,823). It appears that in the context of the tendential decline in the fiscal performance of Madagascar (the tax drag decreasing from 14% of the GDP 1987 to 8 to 9 % in 1996) , the ER which are relatively easier to collect performed better than the overall TR.

2-Calculating the buoyancy and the elasticity of specific excise duties:

The TOPP(Taxes on petroleum products) buoyancy was calculated using the regression method, with the following results :

PRODUCTS	Buoyancy
Fuel (tourism)	0,952
Gasoline	2,099
Paraffin	-

These results show that the "buoyancy" of taxes for petroleum products is higher than the buoyancy of excise duty revenue (ER). Particularly the buoyancy of gasoline taxes is higher by a factor of 2.

To improve, the elasticity of these taxes (TOPP) and those related to beer and cigarettes have been calculated with the following results :

PRODUCTS	ELASTICITY
Fuel (tourism)	0,038
Gasoline	0,038
Butane gas	0,038
Beer	-0,115
Cigarettes	-0,115

It is therefore revealed that even if the calculation of the buoyancy of TOPP had yielded positive results, the elasticity of this tax is almost insignificant. The elasticity of taxes on beer and cigarettes is not only low but negative.

It is on the basis of these different results that one shall later be able to determine whether excise duties in Madagascar can be doubled, with a view to improving fiscal performance.

II-TOPP AND FUEL DEPENDENCY OF MACRO-ECONOMIC STABILITY

The table below shows the following changes : In the early 80's, TOPP products constituted 0,8 to 3,4 % of revenue and donations, 1 to 4 % of tax revenue, and 2,5 to 9 % of products for taxes on goods and services ; in 1995 and 1996 the corresponding percentages were respectively 6,7 to 10,5 %, 7 to 11,7 %, and 26,4 to 47,3 %. At the same time, taxes on goods and services constituted only 22,4 % of revenue and donations and 24,7 % of tax revenue in 1996, as opposed to the respective figures of 33,4 % and 40,9 % in the early 80's.

These changes are therefore characterized by a relative decline in income from taxes on goods and services, with the exception of TOPP. The changes should in fact be viewed within the context of a general decline in fiscal performance in Madagascar, whereby the rate of taxation decreased from 14,6 % in 1987 to 8,4 % in 1995.[1]

So, while expecting a significant improvement in fiscal performance, TOPP rates are, within the framework of the stabilization agreements with the IMF, largely manipulated in order to suit the criteria for management of the budgetary deficit.

	1981	1982	1990	1991	1992	1993	1994	1995	1996
Total revenue & donations	142,7	145,9	611,2	456	608	687	796	1180	1521
Total revenue	142,7	145,9	465.7	354	504	557	749	1149	1405
Current revenue	123,3	131,3							
Tax on goods & services	116,4	126,6	434.3	336	484	527	702	1121	1375
Excise duty on imports(TOPP) in % of R&D	47,6	54,7	102.5	81,4	153	143	202	298,7	340
Taxes on goods & services	1,2	5	5.1	8,4	36.1	58,1	19,1	78,9	161
Excise duty on imports (TOPP) in % of ER	33,4	37,5	16.8	17,9	25.1	20,8	25,3	25,3	22,4
Tax on goods & services	0,8	3,4	0.8	1,8	5.9	8,5	2,4	6,7	10,6
Excise duty on imports	40.9	43,2	23.6	24.2	31.3	27,1	28,7	26,6	24.7
TOPP) in % of taxes on goods & services	1,0	3,8	1,2	2,5	7,5	11,0	2,7	7,0	11.7
Excise duty on imports (TOPP)	2,5	9,1	5.0	10,3	23.6	40,7	9,5	26,4	47.3

Source: STA, Madagascar, 1997

[1] The causes and aspects of this counter- performance are analyzed by the project on "Improvement of the transparency of the Tax Administration"

III-PROPER ESTIMATE OF EXCISES DUTIES TAKING EXTERNAL COSTS INTO ACCOUNT

Taxes on Petroleum Products (TOPP) and road maintenance costs

The procedure which consists of relating TOPP to the costs of maintaining the road network is the one used by a survey funded by the European Union, with a view to establishing a Road Maintenance Fund (RMF). This survey is essentially based on 1996 data and it projects data for TOPP and road maintenance costs for 9 years, from 1997 to 2005. TOPP projections have been calculated on the basis of changes in the GDP, in the transport sector, with respect to its bearing on the GDP and the corresponding fuel consumption. Added to that is the elasticity/cost of the demand for the various categories of fuel.
It should be noted that TOPP figures used are those of 1996.

Projections in terms of road maintenance budget have been based on road maintenance needs as well as the capacity to accomplish these maintenance works.

The following chart compares the results of these two projections :

By constantly maintaining the levels and the structure of TOPP in 1996 from one period to another, the results of the study tend to show that expenditure on road work maintenance will be amply funded from 1997 to 1999.The projected changes in income from TOPP and road maintenance expenditure are almost tangent. Both variables coincide in 1998 and 2005.

2-TOPP and "brown haze"

In this regard, references made to the results from data collected by the National Institute of Sciences and Nuclear Technology (ISTN at Antananarivo) on the urban atmospheric pollution at Antananarivo.[2]
The rate of polluting particles was measured with "Fluorescence X" in the main roadways of the capital city. As for the source of the particles, an analysis of the content of these elements in the fuel distributed by SOLIMA (the sole local petroleum company in Madagascar) was done. This analysis yielded the following figures for lead and bromide.

	Regular	Super	Gasoline
Lead	145 ppm	285 ppm	4 ppm
Bromide	45 ppm	89 ppm	0 ppm

From these figures, it can be concluded that gasoline is least pollutant and that a vehicle using super pollutes twice more than one using regular petrol. From the "brown haze" point of view, the present structure of TOPP in Madagascar is therefore justified, since the volume of gasoline used annually in Madagascar is relatively higher than the volume of regular petrol or super. This conclusion is illustrated by the change in the volume of consumption of petroleum products in Madagascar.

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[2] Evaluation of urban atmospheric pollution at Antananarivo and quest for its source-ISTN-Paper delivered at the Second Madagascar conference on roads-March 1997.

Table for annual distribution in volume (M3) of fuel consumption in Madagascar.

Year	Fuel Super	Fuel Regular	Gasoline
1978	5120	111813	159146
1979	4799	93973	183492
1980	3144	107987	184878
1981	2688	92547	169865
1982	1530	77671	149055
1983	2236	76454	147354
1984	2488	70867	146541
1985	2199	72672	150617
1986	2627	75260	167900
1987	2321	73396	165902
1988	2534	69107	163649
1989	2616	72488	178934
1990	4021	75788	193188
1991	3457	67448	194599
1992	4296	74002	217107
1993	5572	82658	219442
1994	3709	87338	250550
1995	3623	95983	260822
1996	5555	103503	257906

Source: SOLIMA, Madagascar, 1997.

3-TOPP and the consumption of wood-charcoal and deforestation

The interest here revolves around the eventual impact of the levels of TOPP rates on the consumption of fire wood and wood charcoal. For this purpose, a linear model shall be used to attempt to determine the factors and variables which exert a considerable influence on the consumption of charcoal and fire wood in general, and in particular the impact of TOPP rates on the said consumption.

MODEL
The linear model has the following shape :

$Y = f(X,A)$ where

Y is the level of consumption in cubic metres of wood charcoal

X is the vector of the composite explicative variables of TOPP on paraffin.

BEST AVAILABLE

(P), the nominal pump price of paraffin ; the nominal price of wood charcoal, the demographic growth. the inflation rate and nominal GDP as the nearest indicator of revenue and A is the vector of parameters to be assessed.

ASSESSMENT METHOD

Since it is a general linear model, the assessment method to be used will be the least ordinary square (LOS). The quality of the model will be judged in terms of the significance of the parameters, of the importance of the link between the consumption of wood charcoal/fire wood and the other independent variables as well as the absence of correlation between the various independent variables.

DATA USED

The data used to assess the parameters through the LOS method is annual data for two main reasons : available data is available annually and using monthly data could cause errors owing to seasonal variation and could therefore cause auto-correlation of residues.

ASSESSMENT RESULTS FROM THE MODEL

In this regard, firstly, the correlation between TOPP on paraffin (P) and the consumption of wood charcoal by urban households. The selected period is from 1980 to 1989, for which reliable data on the consumption of wood charcoal and fire wood is available.
Multiple regression also includes the following variables :
-The pump price of paraffin ;
-The price of wood charcoal ;
-Population growth ;
-Income, the selected indicator being the real GDP.
These results tend to show that over the period in review, the consumption of charcoal has been correlated to population growth, and not to TOPP at all, not even to the pump price of paraffin. It would be interesting to extend this analysis when reliable data becomes available, by including the 90's, which have been characterized by a significant depreciation of the FMG and the considerable rises of TOPP.

Variables	Coefficient	Normal differential	Factor T	Probability
X1 : TOPP	-0.008	0,037	-0.215	0.843
X2 price P	-0.024	0.081	-0.299	0.784
X3 charcoal price	-0.003	0.055	-0.068	0.949
X4 population	1.815	0.485	3.740	0.033
X5 real GDP (income)	0.413	0.246	1.676	0.192

Regression statistics	
Multiple determination coefficient	0.99
Determination coefficient R^2	0.99
Adjusted determination coefficient R^2	0.98
Normal differential	0.012
Observations	9

VARIANCE ANALYSIS

	Degree of freedom	Sum of squares	Average of squares	F	Critical value of F
Regression	5	0.092	0.018	117.186	0.001
Residual	3	0.000	0.000		
Total	8	0.092			

4- Study on the impact of excise duties on alcohol consumption :

To examine the possible relationship between alcohol consumption and excise duties, a linear model is used, whereby the variable to be explained is the consumption of alcohol. The Neperian logarithm model will be used to measure the elasticity of the impact.

MODEL

VOLUME OF ALCOHOL = f(real GDP, excise duty/alcohol, price of alcohol);

The volume of cigarettes consumed constitutes the variable for explaining the consumption of tobacco. The explanatory variables are : excise duty rates, real GDP and the price (the price of rum being the reference price)

DATA AND ASSESSMENT

The data used for assessment is annual data. The assessment period is ten years. The LOS method shall be used ; the consumption of alcohol is assessed on the basis of annual alcohol sale volumes.

RESULTS

Regression statistics	
Multiple determination coefficient	0.95
Determination coefficient R^2	0.91
Adjusted determination coefficient R^2	0.86
Normal differential	0.22
Observations	9

	Degree of freedom	Sum of squares	Average of squares	F	Critical value of F
Regression	3	2.71	0.90	19.25	0.002
Residual	6	0.28	0.05		
Total	9	3.00			

	Coefficients	Normal differential	T Student	Probability
Constant	1,87	7,51	0,25	0.81
GDP	3,18	2,14	1.49	0.19
Excise duty on alcohol	-1,02	0.18	-5.56	0.00
Price of alcohol	0,23	0,18	1,31	0.24

On the whole, determination coefficients are close to one unit, including the adjusted coefficient. The only significant coefficient is the elasticity of alcohol consumption in relation to the excise duty rates on alcohol. On the other hand, the global significance of each coefficient is assured by the test of the calculated F value which is always higher than the theoretical F. Excise duties have a negative effect on the level of alcohol consumption much as the price of rum does not seem to have had a significant impact on its consumption. The elasticity of the consumption of rum in relation to the real GDP is higher than 1. Alcohol does not seem to be an inferior good in terms of current consumption.

5-<u>Study on the impact of excise duties on tobacco consumption</u> :

In order to examine the link between excise duties and tobacco consumption, a linear model shall be used where the explanatory variable shall be tobacco consumption. To measure the elasticity of the impact, the Neperian logarithm model shall be used.

MODEL

CIGARETTE VOLUME = f(price of cigarettes, excise duty, real GDP)

The volume of cigarettes consumed constitutes the explanatory variable for

tobacco consumption, where the explanatory values are : excise duty rates, real GDP and the price of cigarettes.
(the reference price being the price of the "Melia" brand).

DATA AND ASSESSMENT

Annual data is used for the assessment. The availability of certain series of data is such that assessment by the least ordinary square method shall cover a period of 12 years. The tobacco consumption variable is approximated using the annual volume of cigarette sales.

RESULTS

Regression statistics	
Multiple determination coefficient	0.91
Determination coefficient R^2	0,82
Determination coefficient R^2	0,74
Normal differential	0.27
Observations	10.00

VARIANCE ANALYSIS

	Degree of freedom	Sum of squares		F	Critical value of F
Regression	3	2.06		9.42	0.01
Residual	6	0.44			
Total	9	2.50			

	Coefficients	Normal differential	T Value	Probability
Constant	3.56	8.66	0.41	0.70
Price of cigarettes	-0,01	0.27	-0.02	0.98
Excise duty	0.61	0.24	2.53	0.04
Real GDP	1.19	2.49	0.48	0.65

The levels of the relationship between determination and adjusted determination

show that there is a close relationship between the level of consumption and other explanatory variables. As for coefficients, only the real GDP has coefficients higher than zero. The other parameters are close to zero. On the whole, the significance of these parameters is acceptable. Cigarettes can be considered to be an ordinary commodity (elasticity close to 1).

The positive value of the constant can indicate a situation of demand and consumption independent of these explanatory variables. The price of cigarettes has a negative impact on behaviour in terms of cigarette consumption.

6-TOPP and distributive effects

Lorenz curves established from data collated by the Permanent Household Survey (EPM Madagascar) by Steve Younger et al in "Fiscal Incidence" indicates that TOPP on fuel and gasoline are progressive taxes whereas TOPP on paraffin is regressive. The authors are surprised by these results for two reasons : the Gini coefficient is high in Madagascar (a high degree of income concentration) ; indirect taxes are generally regressive (for example, Ghana).

IV-TOPP ON GASOLINE AS A PERCENTAGE OF THE PRICE OF BUSES, A COMPONENT OF THE COST OF LIVING AND A PERCENTAGE OF TRANSPORT COSTS

1-TOPP as a percentage of the price of buses and the cost of living

In order to deal with this question, reference is made to the table on the cost of using vehicles (CEV), produced by experts from the Malagasy Ministry of Transport, published once in 1996 and still officially valid for the whole country. Since that period this publication has not been updated, but regardless of changes in the price index, the analysis can still be extended. This result is limited to showing, on one hand, the existence of a link between TOPP and the prices of buses and, on the other hand, assessing the intensity of this linkage for any given year.

Fuel therefore represented 12,45 % of the CEV of a bus ; yet, in 1996, TOPP represented 22,84 % of the price of gasoline, and the price of buses 3,14 % of the CPI (consumer price index) ; it would follow that TOPP on gasoline (used by buses) constituted 0,089 % of the CPI.

The table below shows the distribution of CEV by type of vehicle in percentages and, it highlights the importance of fuel and spare parts costs in determining the cost of the services offered by different types of vehicles.

APRIL 1996	LIGHT VEHICLES	TAXIS	PICK-UPS	BUSES	TRUCKS	ALL TYPES
FUEL	23.40	32.13	16,79	12.45	13,95	16,27
LUBRICATOR	3,29	2,06	1.81	1,03	1,02	1,30
TYRES	3,74	4,13	11,28	8,84	13,05	16,19
SPARES	29.36	24.96	26,38	25.96	25,30	26,77
LABOUR	0,45	0.30	0.62	0.33	0.33	0.65
SALARIES	0.00	0.70	0.69	0.43	0.39	0.31
DEPRECIATION	9,71	5.26	9.25	8.70	7,36	5,34
INTEREST	14,07	9,35	16,43	18.48	15,15	10,55
INSURANCE AND OTHERS	15,99	21,11	16,74	23,79	23,45	22,63
TOTAL	100,00	100,00	100,00	100,00	100,00	100,00

Source: Ministry of Transport, 1997

2-TOPP as a percentage of transport costs

Using the same reasoning as above, and knowing that fuel represents 13.95% of the CEV of a truck, and the goods transportation costs 8.02% of the CPI, it can be concluded that TOPP on gasoline (used by merchandise transport) constituted 0.26% of the CPI.
Considering the following parameters:
-the total weight of the various categories of transport (goods, buses, taxis, commuter taxis) on the CPI is to the order of 13.93%;
-the "average" structure of CEV's ("all types" column in the table above) and the assumption that these modes of transport used gasoline only ;
-the weight of petrol "tourism" in terms of CPI is 1,92 %.

It could be concluded that TOPP on gasoline and on petrol "tourism" contituted 1.29 % of the CPI in 1996.

This low weight of TOPP in the CPI seems to be in contrast with the public apprehension vis-à-vis the handling of increases in TOPP rates.
In fact, the reality can be analyzed in the following manner :

For the last fifteen years, the main factor in price increase in Madagascar has been the depreciation of the FMG. Yet the "average" structure of the CEV's, fuel, lubricant, tyres, spare parts costs and depreciation constitute 66,87 % of the CEV's. These components are imported, and are therefore directly affected by any depreciation in the value of the FMG. Without mentioning insurance (22,63 % of the CEV's) which is similarly adjusted in terms of this depreciation. As a matter of fact, any fuel price increase, mainly caused by changes in the price of crude oil and the FMG, and less significantly by TOPP, is exploited by transporters to adjust their overall costs. This can crate the illusion that the increase is link to fuel and TOPP.

Various regional and area surveys have indicated that the transport sector in Madagascar is not competitive.

V- ASSESSMENT OF PUBLIC OPINION

Results obtained by various groups in urban and rural areas show that on one hand, poor urban and rural communities (the majority in Madagascar) are completely unaware of the existence of indirect taxes and on the other hand, only urban and middle class communities as well as the upper class communities are vaguely aware of the existence of indirect taxes. Some members of those communities have a negative opinion of these taxes : they are unfair.

Peasants farmers (producing for domestic consumption and for sale) confirm that since the establishment and the increase in TOPP, their costs in terms of transport expenditure have been on the increase. This observation is very consistent with the latter explanation on the link between TOPP and transport costs : the percentage of TOPP in transport costs is very low and any changes in TOPP will not necessarily have a negative impact. It is the psychological impact coupled mainly with the depreciation of the Malagasy currency FMG, which is the cause of the increase in transport costs.

USAID Cooperative Agreement on
Equity and Growth through Economic Research (EAGER)
Trade Regimes and Growth

GLOBAL TRADE ANALYSIS FOR SOUTHERN AFRICA
THE RESOURCE ALLOCATIVE EFFECTS OF FREE TRADE AREAS IN SOUTHERN AFRICA

Paper presented at the EAGER Semi-Annual Workshop
Johannesburg, South Africa
4-6 February 1998

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[1] I would like to thank Will Masters and Tom Hertel for support, patience and advice; Gerard Malcolm for assistance with computing the shocks; Mark Horridge for the RunGTAP software, without which this paper would not have been completed; and fellow instructors and the participants on the Southern African GTAP Short Course, sponsored by the South African Department of Trade and Industry, for going through these simulations and suggesting improvements. None of them are responsible for remaining errors in the paper.

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Executive Summary

There is currently a great deal of interest in free trade areas in Southern Africa, particularly in the context of South Africa's negotiations with the European Union. This paper uses a multi-country, multi-sector model to examine some implications of alternative trade arrangements. It simulates a sequence of agreements between the European Union and South Africa, working up to a full European Union-South Africa FTA, and then simulates a FTA involving South Africa and the Rest of Southern Africa.

The main conclusions to emerge from the analysis are:

- A partial FTA which does not cover all commodities, nevertheless affects trade in the excluded commodities, mainly through the resource flows in the source country.
- There is the danger of negative trade diverting effects swamping any positive trade creating ones for South Africa in a South Africa-European Union FTA. Trade diversion arises because South African tariffs are currently lower on imports from the European Union than on imports from a number of other sources. This implies that the European Union is not the cheapest supplier and will displace other more cost effective sources if it is given even greater preferences than it currently enjoys.
- The trade creating effects are, for the same reasons, low. Trade creation occurs when domestic producers are displaced by cheaper partner country firms as tariff barriers are removed. But if the initial tariffs are low, the scope for reducing costs are correspondingly low.
- To minimize the costs of trade diversion, and maximize the gains from trade creation, South Africa's tariff reductions should be introduced gradually and applied to all sources on a most-favored nation (MFN) basis. South Africa should examine the possibility of such non-preferential reductions in its tariffs as an alternative to any FTA.
- In any bilateral FTA with the European Union, the gains from trade creation would be greatest from South Africa's initial tariff reductions while the costs of trade diversion would become relatively greater as the tariffs fall towards zero. As a result, in implementing any such agreement South Africa should consider a gradualist approach.
- For the European Union, the trade creating effects of an European Union-South Africa FTA dominate, since the predominant effect is to displace European producers with cheaper South African ones.
- In a South Africa-Rest of Southern Africa FTA, there is scope for trade creation to outweigh trade diversion since intra-regional barriers are high. Low trade volumes mean that the overall gains may be small, but there is scope for reducing intra-regional trade barriers.
- The database and modeling framework offered by the Global Trade Analysis Project provides a fruitful approach for further systematic analysis, to test the preliminary conclusions reached here. The GTAP data and framework are particularly valuable in showing the spillover effects of a trade agreement covering some sectors and countries on other sectors and countries.

Introduction

Historically South Africa has been the dominant economy in the Southern African region. Much of the capital that sponsored the colonization of the region originated in, or was channeled through, South Africa. Migratory labor from the region into South Africa played a crucial part in the development of the latter. In the twentieth century, trade linkages became increasingly important as South Africa exploited the natural advantage afforded it by geographical proximity.

There have been periods in which this economic dominance has been challenged. The immediate post-1948 period saw substantial migration of capital from South Africa, following the uncertainty created by the Nationalist Party's political ascendancy. The Federation of Rhodesia and Nyasaland (1943-1962) protected Southern Rhodesian producers from South African competition in the Federal market. Both of these provided an impetus to Southern Rhodesia's efforts to establish itself as a rival regional economic power. To some extent this was countered during the UDI period, during which Rhodesia's bilateral trade and investment linkages with South Africa were strengthened and South Africa's access to other markets in the region were expanded at Rhodesia's expense.

After Zimbabwe's independence in 1980 there followed a period in which linkages between South Africa and its neighbors were weakened. Particularly during the later part of the apartheid era, the 'natural' economic linkages were broken, partly through the effect of sanctions and partly through military conflicts. The formation of SADCC was seen as a political program to reduce regional dependence on South Africa, not only in the short run, but more importantly in the anticipated post-apartheid era.

With the ending of apartheid, the question of the re-integration of South Africa into the region came once more to the fore. Most governments in the region had the expectation that South Africa's legitimization would provide a boost to the region, particularly by providing a market for their exports. In the event, the South African government has regarded its integration into the region as neither its only nor necessarily its best trade policy option. It has been considering the alternative of integrating into a different economic bloc. Although the formation of a 'South Atlantic Economic Community' with Brazil and Argentina has also been mooted, the creation of a free trade area with the European Union is the most likely. Agreement has already been reached on many aspects of such a FTA and negotiations on finer details continue.

It is not immediately obvious what effects the formation of a SA-EU free trade area (SAEFTA) would have on the rest of Southern Africa. To the extent that it changes the South African economy, there will be important spillovers for the region. The significance of these spillovers will depend on the precise modalities of a SAEFTA.

It is also not clear that this is the best strategy, from either a South African or a Southern African point of view. Would the region grow faster in the absence of a SAEFTA? Would this lead to faster growth in South Africa itself? In so far as they are mutually exclusive options, would the region (including South Africa) benefit more from a Southern African free trade area? Within these broad issues, are there alternative configurations of a FTA which provide better outcomes? If there were a formal establishment of a SAEFTA, what would be the appropriate response of the rest of Southern Africa?

This paper attempts to examine some of these issues. To do so, it employs the publicly available Global Trade Analysis Project (GTAP) database and modeling framework (Hertel,

1997). This provides data on global trade, protection and production on which a multiregional general equilibrium model is constructed. This framework allows a broader consideration of interactions amongst the relevant variables than is possible using either a partial equilibrium or a single country CGE approach.

The data on which the model is based represent global trade, production and protection for 1995. For this paper, an aggregation of the global economy into five regions and seven goods is employed. The 5 regions are:

- South Africa (SAFRICA),
- Rest of Southern Africa (RESTSAF)
- Rest Of Sub-Saharan Africa (RESTSSH)
- European Union (EUNION) and
- Rest Of the World (RESTWLD).

The 7 goods[2] are:

- Agriculture (AGRIC)
- Natural Resource, Extractive and Related Industries (EXTRACT)
- Food manufacturing (FOOD)
- Unskilled labor intensive manufactures (LITMNFC)
- Skilled labor intensive manufactures (TECHMNFC)
- Capital intensive manufactures (HVYMNFC)
- Services (SVCES).

The basic model is essentially a static resource allocation model, best suited for undertaking comparative static analysis of the various resources pulls that emanate from different exogenous shocks. This means that it cannot address directly certain issues that are important for a broader consideration of regional integration. First, it cannot capture growth effects, except insofar as improvements in resource allocation lead to a better foundation for growth. Second, the level of aggregation in the model does not allow it to address some of the more subtle aspects of FTAs. For example, there is the possibility of South Africa's 'partial' accession to Lomé, allowing its exports to the region to qualify in terms of rules of origin. (Jenkins and Naude, 1996). Such issues cannot be captured in GTAP.

This paper has two concerns. The primary focus of the paper is to analyze the changes in resource allocation, trade and output that would emanate from various South Africa-European Union and South Africa-Rest of Southern Africa FTA scenarios. A subsidiary concern is to explore how the multi-regional modeling approach provided by GTAP can be used for trade policy analysis and to suggest ways in which this can be strengthened as a tool for policy makers in Southern Africa.

The paper begins with a brief review of the structure of protection in the three regions as represented in the GTAP data. It then examines the consequences of different FTA arrangements, undertaking a sequence of experiments broadening the scope of the FTA. It then considers how GTAP can be used as a policy tool in Southern Africa.

The Structure of Protection

We begin by reviewing the structure of protection in the three regions in which we are interested, as contained in the base data. Table 1 to Table 3 show the relevant tariff levels. Consider first the average levels of tariffs on imports from each region (Table 1)[3]. We see

[2] For a full description of the aggregations see APPENDIX I

[3] These averages are worked out by comparing the value of the imports in the particular country with their cif world price. They are essentially trade-weighted averages, and thus face the common problem that the trade flow, and therefore the weight, is inversely related to the tariff.

that, if we consider all trade, the European Union has the lowest rate (1.4%) and South Africa the highest (8%). These averages are however misleading since they include intra-regional trade – which is significant but attracts zero tariffs in the case of the European Union – and trade in services, which generally attracts low or zero tariffs. While adjusting for both these influences does not affect the rankings, the difference is narrowed (European Union 4.7%, Rest of Southern Africa 8.9% and South Africa 10%).

Table 1 also shows the average tariffs in each region by country of origin. Here we note that Rest of Southern Africa faces the highest tariffs in both South Africa and the European Union. South African imports into the European Union face, on average, higher tariffs than those from either the rest of sub-Saharan Africa or the rest of the world. This feature exerts an important influence on our subsequent analysis of an South Africa-European Union FTA, since these change the structure of preferences in favor of South Africa.

Table 2 gives similar averages distinguishing between types of commodity. In South Africa, light manufactures attract the highest nominal protection (36.6%), with food and high tech manufactures also receiving substantial protection. The Rest of Southern Africa appears to have a more uniform tariff structure, with lower rates on light manufactures but higher on agriculture. In the European Union, most nominal protection is afforded to food and agriculture. Table 3 gives more disaggregated data.

This preliminary review of the tariff structures for the three regions suggest that:

1. a South Africa-European Union FTA would have the most impact on South Africa if it freed up of trade in food and agriculture. As Table 3 shows, the tariffs faced by other South African exports to the European Union are relatively low.
2. From the European Union's point of view, removal of South Africa duties on non-agricultural[4] imports would appear to provide the most action.
3. The high barriers on bilateral trade in light manufactures between South Africa and its neighbors suggest there may be considerable gains from a South Africa-Rest of Southern Africa FTA.

These three features give some pointers to the political problems entailed in the formation of such FTAs. The lower tariffs on non-agricultural imports into the EU suggest that it may be politically easier to move on these goods first. The current negotiations between South Africa and the EU suggest that agricultural goods are likely to be excluded from the final arrangement, or at most covered only partially. The protection of light manufactures within the Southern African region also highlights the difficulties that have already been encountered in negotiating trade agreements in the region. All the countries appear to see this sector as providing an engine for industrial growth, requiring protection.[5]

Having sketched these stylized facts about the structure of protection, we now turn to considering the consequences of different FTA arrangements. We focus initially on South Africa-European Union FTAs. We begin with a simulation of a non-reciprocal reduction in the EU of tariffs on imports of non-agricultural goods from South Africa. This simulation is discussed in some detail since it provides an straightforward example of the way in which GTAP allows such issues to be analyzed. It also provides a good basis for discussing the ways in which a GTAP simulation can be interpreted. We then broaden the experiments, first by including South African agricultural and food exports to the EU. Although this one-sided reduction in tariffs does not represent the formation of a FTA, it is nevertheless of interest,

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[4] Throughout this paper, "non-agricultural" refers to all commodities other than agriculture and food.

[5] Given the long period for which some of these industries have existed in the region, it would be something of a misnomer to call them 'infant industries'.

given the suggestion that the transition to a FTA should involve an immediate reduction of tariffs in the EU coupled with gradual reduction in South Africa (cf. Jenkins and Naude, 1996). Having looked at the results of these two experiments, we then consider experiments that create a proper FTA, starting by reciprocal removal of duties on non-agricultural goods and then including agriculture and food. These first four simulations do not change tariff barriers relating to the rest of Southern Africa. Our final experiment explores the consequences of a Southern African FTA. This provides a basis for comparison with the South Africa-European Union FTA.

This set of experiments does not exhaust the range of possible configurations of the various FTAs. Possible extensions include examining the consequences of:

- the removal of export subsidies and/or harmonizing output taxes within each FTA, providing a more level playing field;
- incorporating both regional groupings in a FTA;
- removing intra-regional trade barriers in the Rest of Southern Africa as a response to a South Africa-European Union FTA;
- different sequencing scenarios.

It is hoped that the simulations reported in this paper will show how a framework such as GTAP can be useful in examining these kinds of issues and informing policy.

South Africa - European Union Free Trade Arrangements

Non-reciprocal removal of import duties on non-agricultural imports from South Africa into the European Union (SEFTA1)

What happens when the European Union removes all import tariffs on non-agricultural imports from South Africa? From a policy maker's point of view, an appropriate point of departure is to consider how this affects sectoral outputs in each region. Table 4 gives the results of the simulation. In South Africa, only light manufactures experience an increase (1.9%). All other sectors decline. It is interesting to note that there is an effect on both agriculture and food production, even though the European Union tariffs on these goods was not changed. The reason for this lies in the general equilibrium feedbacks in the model. This is perhaps the first important insight we get from using GTAP for this simulation. It reminds us that expanding the output of a particular sector feeds back into an increased demand for inputs – both primary and intermediate – into that sector and that we have to address the issue of where those resources will come from. In the basic GTAP model we have used, this resource constraint shows up in quite a tight way. We can relax this constraint by modeling, say, unemployment amongst unskilled workers, but although this moderates the constraint , it does not remove it. Expanding sectors still have to find additional inputs. While they may be able to draw in unskilled labor from the pool of unemployed, they have to attract the remaining inputs from other sectors in the economy. If these are not in perfectly elastic supply, there will be price changes that will in turn feed back into costs of production and supply responses.

Table 6 shows the changes in prices in South Africa for this simulation. The price of land falls, reflecting the impact of declining agricultural output on an input that cannot be reallocated to any other use. All other prices – of both factors and goods – rise.

It may not be clear why the output of other sectors benefiting from the European Union liberalization should decline. This is because the rising prices interact with the structure of production in these sectors so that the upward shift in their supply curves more than offsets the outward shift of their demand curves. To work this through fully is possible, but rather tedious and we simply sketch out the main stylized facts here. Consider the input proportions

in South Africa in the base data as shown in Table 5. We can start by considering the relative intensities between factors and intermediate inputs. We see that, for example, in agriculture, factor inputs constitute 54% of input costs, while in food they comprise only 20%. We thus expect changes in prices of factors to have a bigger effect on the costs of production in agriculture than in food. We can then consider the composition of each broad type of input. Extraction and high tech manufactures have similar proportions of factor inputs but we see that in extraction 32% of the factor costs are derived from capital inputs, as opposed to 48% in high tech manufactures. Thus, other things being equal we would expect a rise in the price of capital inputs to impact more seriously on costs in the latter. This effect will be mediated through substitution possibilities. We can also look at the composition of intermediate inputs and work through the same implications. A rise in agricultural prices will, for example, have little effect on its costs, but will push up costs of food production, not only directly because it comprises 32% of purchased inputs, but also indirectly because food is and important input into the production of food. There will thus be a significant second round effect.

Table 4 also shows that output rises in most sectors in the Rest of Southern Africa, albeit by small amounts. We will see (page 6) that this is a consequence of an increase in South African imports. It is perhaps useful first to think about the interpretation of the results given in Table 4. While the strict interpretation is that output of agriculture in South Africa falls by 0.5%, while that of light manufactures rises by almost 2%, a broader interpretation is that this shows *relative* changes between the sectors. In other words, as the economy grows this particular trade agreement will result in agriculture being 0.5% smaller than it would otherwise have been. It would be wrong to look at these results and conclude that the agreement will lead to the decline of the agriculture sector.

In many studies of the impacts of a tariff reduction, a partial equilibrium approach is taken. Estimates of elasticities of demand are combined with the tariff reduction to estimate what the likely impact on the volume of imports will be. Such a back of the envelope calculation can give good results and is often useful where we have detailed line-by-line import data. In this case, if the tariff reductions are neither large nor cover a wide range of products, it may be reasonable to make the *ceteris paribus* assumption required to ignore feedbacks. However, we can use the current simulation to point to some of the dangers by contrasting the effects on South African imports into the European Union estimated by the two approaches. Table 8 compares the results. The main difference between them is that while our back of the envelope calculation suggests that there would be no change in the flow of agricultural goods, since the European Union tariff on these goods is not changed, the GE simulation shows that these will decline. We have already seen the reason for this: it is a consequence of the outflow of resources from agriculture into the four liberalized sectors. Agricultural production in South Africa thus declines, as was shown in Table 4.

The second noticeable feature of our comparison between the back of the envelope and GE results in Table 8, is that even in those sectors in which the tariff was reduced, the expansion of imports is sometimes less than we would have predicted and sometimes more. Again the reason for this is the feedbacks that the GTAP model captures, particularly as regards production costs in South Africa. Changing input prices interact with different input intensities to produce non-uniform cost changes in the sectors. It is possible under GTAP to explore the cost structures of sectors in order to anticipate what the outcome of this process will be.

An important result concerns what happens on the balance of trade in South Africa. The expansion of her exports to the European Union improves the overall balance of trade. However, we would expect her imports to rise even faster. This result arises for several

reasons. First, as production in South Africa rises, clearly more imports will be sucked in. It is possible for South African producers to substitute domestic for imported inputs, but only imperfectly. But while this process explains why imports should rise as exports rise, it does not explain why they should rise at a *faster* rate. To explain this we have to think through some of the macroeconomic structure of the model.

In an open economy, macroeconomic consistency requires that savings less investment in any region must equal its exports less imports (or the balance of trade). It is only possible for a country to invest more that it saves (or spend more than it produces) if there is a net inflow of resources. The domestic savings gap has to be filled by foreign savings. In this simulation savings is not significantly affected – the overall impact on income is relatively small. (regional real income rises by 0.96% as does real savings). However, investment rises faster. The demand for capital services has risen, so the rental price of capital rises. At the same time, although the price of capital goods rises, it does not keep pace with the rental price because some capital goods are imported. These two forces raise the return on capital encouraging more investment. If investment is rising faster than savings, imports must be rising faster than exports.

This increase in imports is the main channel through which this trade agreement affects the rest of Southern Africa. Table 9 shows how South Africa's imports from each region have changed and we see that there is an across the board rise for all commodities from all regions. The importance of South Africa as a market for the rest of Southern Africa means that this translates into rising output in the region, as shown in Table 4. This in turn affects prices and incomes in the region.

From this broad assessment we would conclude that this non-reciprocal trade agreement is beneficial to South Africa, which experiences rising output and rising exports. For the rest of Southern Africa however, there is a decline in real investment and real GDP. Although its exports to South Africa increase, those to other regions decrease, partly because of rising costs of production and partly because of increased competition from South Africa in the European Union. The relative importance of these other markets means that there is a net decline in exports.

GTAP allows us to go further in the analysis of the costs and benefits by undertaking a welfare analysis, decomposing the changes in welfare into their component parts[6]. Table 10 provides a summary of the sources of welfare changes for all regions. All the impacts come from changes in either allocative efficiency or terms of trade.

The table shows that South Africa is the only region to experience positive welfare gains. Approximately 25% of this change occurs because of allocative efficiency effects, while the remainder comes from terms of trade effects.

The terms of trade gain should come as no surprise, since the SEFTA1 experiment increases the demand for South Africa exports. Table 11 shows which sectors the TOT effect derives

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[6] The welfare analysis allows us to place a monetary value on the on the assessment that a region has about the desirability of a particular change. In essence it allows us to say that the effect of a policy change is equivalent to increasing a region's income by x million dollars. Although the precise figure depends on assumptions about welfare functions and the structure of the model, it nonetheless does give us a metric for weighting the different effects. We should note too that, although this may seem to policy makers to be the kind of abstruse game academic economists play, the technique is used in other circles (for example, when estimates are made of the costs of declining primary product prices for SSA).

from in each region. One can see that there are no gains to any region other than South Africa. In South Africa high tech manufactures accounts for more than 25% of the overall gain. Note that, as we would expect, the net TOT effect for the global economy is zero (to machine accuracy): terms of trade changes are, for the world economy, a zero-sum game.

Further insight into the sources of these gains can be obtained by decomposing the sources of the $231 million contribution of TOT to South Africa's welfare gain. This is shown in Table 12. From this table, we observe that virtually all of the TOT gain is due to an improvement in the price of exports from South Africa. Note that all exports benefit from the price increase, since at its root is the increased demand for primary factors in SAFRICA.

If we take a similar look at the negative TOT effects for the EU, we see that these emanate mainly from declining export prices (Table 13). These are offset slightly by gains that come from falling import prices, especially for heavy manufactures. The terms of trades effects are of interest but not unexpected. Furthermore, although they dominate the welfare effects, they are likely to be eroded over time as exports from other regions erode the demand for higher priced South African exports in the EU.

The allocative effects, which arise because of improved efficiency in the economy, are of more interest. These effects relate to the trade creation/trade diversion story. One way to interpret them is that a welfare gain from this source arises because a country is moving closer to its comparative advantage pattern of production; a welfare loss implies a movement away from comparative advantage.

Why should removal of EU tariffs on imports from South Africa improve allocative efficiency in South Africa? This is a complex story, but the bottom line is that the economy has shifted resources into relatively higher value uses. Table 10 shows that although South Africa is the only country to experience an improvement in allocative efficiency, its gain more than outweighs the collective losses of the other regions: there is thus a net improvement in global efficiency. This is what we might anticipate – a reduction in tariffs is good for the global economy – although second best considerations might counter this.

The allocative efficiency summary by commodity is shown in Table 14. Here, we see that high tech manufactures generate the most gains – both for South Africa and for the global economy. It is not immediately obvious why this should be so, since high tech manufactures neither received the largest tariff reduction nor did it experience the greatest expansion in imports by the EU from South Africa. We need to explore this further.

We can also divide up the welfare gains by type of distortion (tax). This is done in Table 15. Note that the totals for these two types of breakdowns are the same. However, what Table 15 shows is that it is the change in imports, interacting with the import distortions which gives the bulk of the gains. Why would this arise? First of all note that the existence of tariffs in South Africa lends preference to the domestic product, relative to imported goods. Thus consumers are not able to consume as many imports as they would in the absence of tariffs. When exports to the EU surge under the FTA, domestic costs rise, causing a switch away from domestic towards imported supplies. Indeed, in the absence of any changes in domestic savings and investment, we would expect the trade balance to remain unchanged so that aggregate imports to rise by the same amounts as exports. At the margin, these goods are more valuable to consumers than the domestic good they displace and a welfare gain arises.

Table 16 shows the sources of welfare changes arising in the European Union from imports of light manufactures. Note that **the volume of imports from all sources rises by $48.5m.**

This represents trade creation – more expensive domestic production is being replaced by cheaper imports – which is a good thing. (The traditional trade creation/diversion analysis might stop at this point). However, we can see that from a welfare point of view, this increase in import volumes actually is associated with a welfare *decline*. Why is this?

Prior to liberalization, South Africa's exports of light manufactures into the EU face relatively low import duties. On the other hand, those from RESTSAF and ROW are relatively heavily taxed. In this model, abstracting from other distortions, this means that these other regions are relatively lower cost *cif* suppliers at the margin.[7] This means that non-preferential liberalization would lead to a marginal increase in those regions' shares. This would be a good thing for the global allocation of resources in general and for the EU consumers in particular. However, the FTA implemented here is preferential to South Africa. It causes South Africa imports to displace those from the other, lower cost, regions. Thus, while increased imports of light manufactures from any source is a good thing, insofar as it displaces higher cost domestic production, the preferential liberalization is a bad thing. Rather than moving to the lowest cost supplier at the margin, the EU is instead moving towards a higher cost source of imports.

We see then that the reduction of tariffs on South African imports sets in motion two effects which have contradictory effects on welfare. Beneficial trade creation occurs, as more efficient South African producers replace less efficient European Union ones. But there is also harmful trade diversion as more costly South African imports displace cheaper ones elsewhere in the world.

The disparity in tariffs is worsened as liberalization is implemented, since by the end of the shock, the South Africa tariff is zero, versus almost 10% from RESTSAF. In other words, if the FTA was implemented by reducing the tariffs gradually over time, the initial reductions would be dominated by the trade creating effects, as the protection to European Union producers is highest. However, once there have been tariff reductions, the trade diverting effects take over, as the preference given to South Africa over other supplying regions increases and the protection to European Union producers is low.

If the initial tariffs on a commodity were more uniform and generally lower, the diversion would not be so costly and welfare might actually improve. We see this if we look at a similar decomposition for high tech manufactures (Table 17). Here again the change in net import volumes is positive. However, because the initial tax rates are both lower and more uniform, the preferential reduction of tariffs on South Africa imports has less harmful effects on the European Union. The positive welfare effects of trade creation cancel out the negative ones from trade diversion.

Finally, in the case of heavy manufactures, tariffs are even more uniform and lower, and effect on welfare now coincides with the volume change – both increase (Table 18).

We see from Table 10 that the net effect of allocative changes on welfare in the EU is negative (-$18.4). One of the main reasons for this is the decline in agricultural and food imports into the European Union. Essentially, less efficient EU producers are displacing more efficient foreign ones.

In contrast to the EU, efficiency goes up in South African import markets. Why is this -- tariffs are not being reduced there in this simulation. However, as we saw in the discussion

[7] In equilibrium, the cif prices plus import duties will be the same for imports from all sources. Therefore those sources which have higher import taxes must have lower cif prices.

on page 6, South African imports rise in this experiment both because exports rise and because investment rises faster than savings. A greater volume of imports moving across the relatively high trade barriers, generates welfare gains – South African consumers get to raise the share of goods from lower cost foreign suppliers in their consumption basket. See for example Table 19 for LITMNFC imports below.

Non-reciprocal removal of all import duties on imports from South Africa into the European Union (SEFTA2)

The effects of extending the previous trade agreement to allow all South African exports – including agriculture and food – to the European Union duty free access should not be surprising. Since the tariffs on these two sectors are highest, they experience a large surge in demand. Whereas in the previous simulation the benefiting sectors could draw resources in from agriculture and food, now the resource pulls are in the opposite direction. We see from Table 20 that food and agricultural output in South Africa rise sharply, and that all other sectors decline. Table 21 shows the related price changes. In South Africa there are significant increases in prices for all factors and commodities except natural resources, which falls because of the decline in output in the extraction sectors. However, what is of interest is not the rise in all prices, but rather the change in relative prices. On the basis of Table 21, we can deduce that, amongst the commodities, SVCES, FOOD and AGRIC experience greater price rises than the average. There is thus a relative pull towards these sectors. This is counteracted by what is happening on the cost side. Although all sectors experience increases in the price of their endowment and intermediate inputs, the impact of this on costs depends on the input structure and the response of producers in terms of substitution between inputs as discussed previously (page 5). Table 22 compares the price and output changes under the two simulations. Broadening the coverage of the agreement results in more substantial price rises. It also changes the relative prices. Under SEFTA1 the increases in prices are fairly uniform and therefore do not change relative prices much. Under SEFTA2 the price changes and highlights how the extension of the preferences to agricultural goods changes the direction of the changes.

What about changes in trade flows? Table 23 illustrates the dramatic increase in Food and agricultural imports from South Africa by the European Union. This response is the result of a combination of substitution by European purchasers of South African for domestic supplies and of South African imports for those from other sources. It can be seen that share of the Rest of Southern Africa in the European Union market declines. This is significant when we come to look at the impact on the region. Although this loss is offset by the increase in its exports to South Africa (South Africa imports 18.8% more agricultural goods from the Rest of Southern Africa and 10.3% more food), exports from the Rest of Southern Africa rise by only 0.03%. It is losing shares in a big market (in the base data, South Africa accounts for only 4.1% of the Rest of Southern Africa's exports, while the European Union accounts for 37.5%).

Assessing the impact on the overall economies, real GDP rises by less than 0.1% in South Africa, by even less in the European Union and falls elsewhere. The biggest fall is in the Rest of Southern Africa. However, as we saw earlier, this measure does not capture the welfare effects of the change. Table 24 shows the overall welfare effects and its decomposition. The results from SEFTA1 are included for convenience.

It will be seen that there is a much larger welfare gain for South Africa. As before this is mainly because of the terms of trade effects, which accounts for over 86% of the gain. There has been an increase of over 2.5% in the price of South Africa's composite exports, as might be expected. At the same time, the price of its import composite has fallen slightly. The

reason for this fall is that the rise in aggregate import demand (by 5.4% in real terms) results in a change in the composition of imports by origin, with a greater proportion being sourced from cheaper suppliers.

The bulk of the efficiency gains in South Africa arise because of the greater volume of imports. Essentially South Africa is moving closer to its comparative advantage production pattern, with a greater share of goods being supplied by cheaper foreign producers rather than (protected) domestic ones. The European Union suffers a decline in overall welfare, worth $374m. There is a sharp deterioration in its terms of trade. This is somewhat offset by an improvement in allocative efficiency. Again this is a result of switching from domestic supplies to cheaper South African imports. In the case of agriculture, which receives an average 12% subsidy in the European Union, this trade creation is doubly beneficial. There is a counteracting trade diversion in the composition of imports from other cheaper sources towards South Africa, but it is insufficient to negate the trade creating effects.

Finally, what is the impact on the Rest of Southern Africa? We have seen that although its exports to South Africa rise sharply, overall exports rise by only 0.03%. When combined with the slight improvement in its export price index, this gives an increase in export earnings of only 0.09%. At the same time expenditure on imports falls by 0.3%, despite a rise in the price of imports. The result is a positive change in the balance of trade of $53m, from -$475m to -$422m. However, real GDP falls slightly and the terms of trade move against the region. Welfare declines, dominated by the terms of trade effects.

Reciprocal removal of import duties on non-agricultural trade between South Africa and the European Union (SEFTA3)

When the narrow reciprocal FTA is introduced, the effects mirror some aspects of the first simulation. Although there is an opening up of markets for both members of the FTA, the shift of resources out of the non-included sectors leads to their decline. In South Africa, extraction is the only sector to experience an increase in output. However, the biggest increase in output is in capital goods. This reflects rising investment demand as the rate of return on capital increases under the FTA. In the European Union, a similar flow of resources is experienced, with agriculture and food output declining as light and high tech manufactures expand. Both regions pull in imports of agriculture and food from other parts of the world.

At the same time, the attempt to increase output leads to price changes. As Table 26 shows, most factor prices in South Africa rise, while most output prices fall. The explanation for this is the increased investment. This increases demand for inputs sufficiently to offset the falling demand elsewhere.

Table 27 to Table 30 show that the impact of this arrangement on trade flows differs strikingly from that under the non-reciprocal arrangement (SEFTA1). In that case the removal of tariffs on non-agricultural goods led to a fall in European Union imports of agriculture and food from South Africa. We saw that this result was essentially supply driven. Now, as we see from Table 27, imports of all goods from South Africa rise. The flows are higher in all sectors than they were under SEFTA1. On the export side there is a sharp increase in the exports of light manufactures from the European Union to South Africa. Again this contrasts with the non-reciprocal arrangement.

The overall welfare effects of this FTA on South Africa are negative, with both ToT and allocative efficiency losses. The former, which occurs for the first time in our simulations, arises because of declining export prices, driven mainly by falling domestic price levels.

Table 32 puts the light manufactures imports into South Africa under the spotlight. Here we see that the volume of imports rose by $647m, but there was a negative welfare impact. This was because of the trade diverting effects of the FTA. Previously the European Union faced tariffs of 31.6%, compared to those on light manufactures imports from the Rest of Southern Africa of 40.9% and the rest of the world of 38.0%. The FTA has caused a switch from these other, cheaper sources towards the more expensive European Union suppliers. The net effect is a loss in welfare in South Africa. Contrast this with what happens in the European Union. There both volume of imports of light manufactures and its welfare contribution rise. The difference here is highlighted by the fall in the volume of intra-European Union imports ($205m). This represents trade creation.

It could be argued from these tables that the main effect of this FTA is to impose a trade diversion cost on South Africa while the European Union reaps a trade creating benefit. Of course, the full range of imports should be analyzed before one can come to this conclusion. However, South Africa's loss in allocative efficiency highlighted in Table 31, suggest that this is a warranted conclusion.

Reciprocal removal of import duties on all trade between South Africa and the European Union (SEFTA4)

We now come to the full South Africa-European Union FTA, in which all trade flows between the two are liberalized. This has a much more significant impact on sectoral outputs than did the narrower FTA. As we might expect, free access to the European Union market gives a big boost to food and to agricultural, whose outputs rise by 7% and 6% respectively (Table 34). There is also a rise in CGDS output, related to increased investment. The other sectors experience a relative decline, with light manufactures suffering the most.

Table 34 also shows that this FTA has a more significant effect on the Rest of Southern Africa. To trace this through, examine Table 36 to Table 39. From Table 39 we see that South Africa's agricultural and food exports to the European Union rise dramatically, while those to other regions fall. South Africa is induced by the FTA to switch markets. This switching is not only away from other foreign markets but also from the domestic market towards the European Union. This explains the simultaneous increase in imports of agricultural goods.

We can consider the impact of this FTA on welfare by thinking about the trade creation/diversion effects. Firstly in Table 40, we see that although both South Africa and the European Union gain from the FTA, in South Africa there is a large positive ToT effect that is somewhat diminished by the negative resource allocative effects. The negative effects of the previous simulation have now been countered by rising export prices as South Africa penetrates the European Union market. The negative effects via resource allocation are still dominated by the trade diversion effect, although there is a small effect deriving from domestic distortions. As the FTA induces South Africa to produce more, it expands production of subsidized commodities, reducing its allocative efficiency.

The trade creation/diversion story can be illustrated again by looking at the welfare contribution of the changes in imports of light manufactures (se Table 41 and Table 42). South African imports of light manufactures rise by $703m. However, this has a negative impact on welfare, because of the substitution of European Union for other sources of supply. (the same inverse relationship occurs in imports of high tech manufactures, but not with the other commodities. In the case of food imports, opening up to the European Union induces a welfare gain, because European Union food previously faced the highest tariffs in South

Africa.) For the European Union the reverse is true. Welfare rises along with import volumes, because of the displacement of intra-European Union trade by more efficient producers abroad. There are no commodities for which the inverse relationship is observed.

A Southern African Free Trade Area (SEFTA6)

The most significant output effect of removing all tariffs on trade between South Africa and the Rest of Southern Africa (including those on trade amongst the countries making up the latter) is on light manufactures in the Rest of Southern Africa, which rises by almost 29% rises[8] (Table 43). There is little impact on other sectors. In South Africa the output effects are small. In both partners, there is a negative effect on agriculture. This result reflects the regional comparative advantage of the Rest of Southern Africa in light manufactures and the current high tariff barriers on trade in these commodities. Essentially, sub-regional producers replace domestic ones in the South African market. Resources flow into the sector from elsewhere in the economy.

Table 44 shows that prices rise in the Rest of Southern Africa, except for land and natural resources. This reflects the impact of declining output on a sector specific factor, as discussed previously. The rising prices choke off some of the expansion that might otherwise have occurred.

Table 45 to Table 48 show what happens to trade in the two partner regions. Trade within the Rest of Southern Africa rises substantially, particularly in light manufactures. Imports of light manufactures from South Africa rise by some 254% (partly a reflection of the low initial flows). At the same time exports of this commodity to South Africa rise by 643%[9]! Imports and exports to other parts of the world both decline, reflecting substantial switching of markets caused by the FTA. The exception is agricultural imports, which rise to plug the gap caused by reduced output. Table 47 and Table 48 show a similar pattern for the changes in South Africa's imports and exports.

The previous tables show the percentage changes in each bilateral flow. It is difficult to gauge from these figures what the overall impact is. Table 49 compares the changes in volumes of imports and exports for the two partners under this FTA with those occurring under the South Africa-European Union FTA simulation. The FTA with the European Union increased South Africa's import volumes by $3621m and its export volumes by $1586m. Under the SADC related FTA, both volumes rise by approximately one quarter of these amounts. The latter has a much smaller impact on South Africa's trade than the former. For the Rest of Southern Africa the reverse is true. Not only are the levels of the changes different but their signs are reversed. South Africa joining with the European Union reduces trade volumes for the Rest of Southern Africa; a SA-SADC FTA raises them substantially.

As we have seen, GTAP allows one to compute the welfare gains from any exogenous change. Table 50 shows the welfare decomposition under a SA-SADC FTA. Both partners to the agreement gain. As usual the effects are dominated by terms of trade effects which occur because of rising export prices. There is little trade diversion because the initial tariffs on the partner countries are high relative to other trade partners. However, Table 51 and Table 52 show that some does occur in light manufactures, where there are high tariffs on other sources as well.

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[8] Light manufactures includes textiles and clothing (see APPENDIX I: Commodity Aggregations). This effect is thus in accord with the view that improved access to South African markets for these commodities is important for regional growth.

[9] The ability of GTAP to capture increases in the trade flows of a good in both directions is a strength compared to models based on homogeneous commodities.

Conclusions on Free Trade Areas

Do any clear conclusions emerge from the mass of tables and figures presented? First, we should be clear about what the analysis does **not** address. The focus is on resource allocation effects. It does not address issues such as creating a commitment strategy for domestic policy credibility (see Jenkins and Naude, 1996) and bargaining strategies in trade negotiations. It also does not address long term growth problems, except in so far as improving efficiency in an economy enhances its growth prospects[10].

Within these limitations, what conclusions can we draw? A major theme of the paper has been that the FTAs all entail trade diversion effects that can swamp other positive gains. We saw that in the narrow version of the South Africa-European Union FTA – which most closely resembles the version that seems currently to be on the table – the model suggests that the trade diverting consequences for South Africa may negate other benefits. In the light of this, it is as well to recall that the trade creation effects arise because of reduced protection for domestic producers and can be acquired by unilateral non-preferential tariff reductions. One possible extension to the current paper might be to consider explicitly whether South Africa can achieve the gains from an FTA without incurring the costs, by reforming its own tariff structure outside any FTA. This option is often overlooked in negotiations about FTAs.

A second conclusion we could draw stems from the initial discussion of the structure of protection. There it emerged that tariff rates on the sub-regional trade are discriminately high. The Rest of Southern Africa already faces higher barrier in the South African market than does the European Union. Tariffs on trade within the Rest of Southern Africa are also high. Although the final simulation suggested that there is not much benefit for South Africa in a regional FTA, there is scope for exploring further the benefits that might accrue from reducing these barriers.

Finally, we might consider the usefulness of a multi-regional, multi-commodity model for analyzing topical policy issues such as FTAs. If this nibble has created a desire to consume the whole meal, the question then arises as to how the tool can be strengthened. A number of areas for action suggest themselves.

- Developing the database. The usefulness of the model in any circumstances depends on both the reliability and suitability of the data. This is the main motivation for the GTA project: to develop consistent and reliable data for global trade policy analysis. Clearly a focus on this in the Southern African region while provide a better basis for informed policy making.
- Developing the modeling capacity. We need to develop our own capacity, not simply to use the tool but to adapt and extend it. This requires recognition of the need not only for training but also for hands on experience using the tool.
- Developing policy makers' absorptive capacity. In order to translate the results of analysis into effective policy, policy makers need a critical understanding of the basis for the recommendations. Here again, experience is probably the best teacher; but it can only teach if there is a receptive attitude.
- Regional cooperation in policy analysis. Perhaps it is important to develop the necessary tools and capacity on a regional basis.

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[10] It is possible to use GTAP to examine some aspects of growth by making suitable estimates of exogenous changes which affect growth (like population growth and technical change) and to incorporate these into the simulations. This will, however, tell us more about the consequences than the causes of growth.

Finally, it is only by strengthening our capacity to make informed policy decisions, based on competent applied analysis, that we will make our way in the global economy. But that perhaps reflects the bias of an academic modeler.

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Tables

Table 1: "Average" Tariff Rates by Source

	SAFRICA		RESTSAF		EUNION	
Source:	All	Excl SVCES	All	Excl SVCES	All	Excl SVCES
SAFRICA	0.0	0.0	5.9	6.0	4.8	5.5
RESTSAF	16.8	17.6	6.1	6.5	14.3	15.4
RESTSSH	1.8	2.0	7.6	10.0	3.0	3.2
EUNION	6.3	8.2	7.5	9.4	0.0	0.0
RESTWLD	9.3	11.4	7.1	10.6	3.6	4.6
Total incl Intra	8.0	10.0	7.0	8.8	1.4	1.7
Total excl Intra	8.0	10.0	7.0	8.9	3.7	4.7

Table 2: "Average" Tariff by Commodity

	SAFRICA	RESTSAF	EUNION1	EUNION2[1]
AGRIC	5.9	8.3	4.7	10.3
EXTRACT	0.5	6.0	0.4	0.5
FOOD	12.7	10.4	3.4	21.4
LITMNFC	36.6	17.3	3.1	6.8
TECHMNFC	10.6	7.2	1.4	3.9
HVYMNFC	4.9	7.5	0.8	2.8
SVCES	0.0	0.1	0.0	0.0
AVG ALL	8.0	7.0	1.4	3.7
AVG excl SVCES	10.0	8.8	1.7	4.7

[1]This column excludes intra-European Union trade in estimating the average

Table 3: Import Tariffs by Commodity in Various Regions (%)

A: South Africa

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	6.6	0.4	6.5	6.5
EXTRACT	5.2	0.9	1.1	0.3
FOOD	12.4	6.8	20.4	9.2
LITMNFC	40.9	12.8	31.6	38.0
TECHMNFC	11.5	8.9	8.0	13.3
HVYMNFC	4.6	5.7	4.7	5.2
SVCES	0.0	0.0	0.0	0.0

B: Rest of Southern Africa

	SAFRICA	RESTSAF[11]	RESTSSH	EUNION	RESTWLD
AGRIC	1.7	3.4	9.7	13.6	11.4
EXTRACT	4.1	3.6	3.3	7.6	9.4
FOOD	6.9	8.9	5.9	12.0	11.9
LITMNFC	21.9	21.4	22.2	16.4	16.6
TECHMNFC	4.8	5.0	6.3	7.3	8.4
HVYMNFC	5.3	5.5	7.0	11.1	8.1
SVCES	0.5	0.1	0.1	0.1	0.1

C: European Union

	SAFRICA	RESTSAF	RESTSSH	RESTWLD
AGRIC	15.3	32.6	6.1	10.2
EXTRACT	1.0	0.9	0.5	0.5
FOOD	40.0	57.3	10.4	21.3
LITMNFC	4.5	9.5	3.6	6.9
TECHMNFC	3.3	4.5	3.2	3.9
HVYMNFC	2.9	2.6	3.1	2.8
SVCES	0.0	0.0	0.0	0.0

Tables Relating to SEFTA1

Table 4: Changes in Output by Region (%)

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-0.46	0.04	0.00	0.01	0.00
EXTRACT	-0.21	0.02	0.00	-0.00	0.00
FOOD	-0.12	0.08	0.00	0.00	0.00
LITMNFC	1.92	0.05	-0.01	-0.02	-0.00
TECHMNFC	-0.19	0.03	0.00	0.00	-0.00
HVYMNFC	-0.28	0.14	0.02	-0.00	0.00
SVCES	0.04	-0.06	-0.00	0.00	-0.00
CGDS	1.01	-0.60	-0.02	-0.00	-0.01

[11] These figures reflect the import taxes on intra-regional trade in RESTSAF.

Table 5: Input Proportions in South Africa in the Base Data

	AGRIC	EXTRACT	FOOD	LITMNFC	TECH MNFC	HVY MNFC	SVCES	CGDS	TOTAL
Land	0.15	0.00	0.00	0.00	0.00	0.00	0.00		0.01
UnskLab	0.39	0.32	0.46	0.63	0.43	0.40	0.40		0.40
SkLab	0.01	0.06	0.10	0.10	0.09	0.08	0.26		0.20
Capital	0.45	0.32	0.44	0.26	0.48	0.52	0.34		0.38
NatRes	0.00	0.30	0.00	0.00	0.00	0.00	0.00		0.01
Factors	**0.54**	**0.40**	**0.20**	**0.34**	**0.42**	**0.36**	**0.54**	**0.00**	**0.42**
AGRIC	0.10	0.00	0.35	0.03	0.00	0.01	0.00	0.00	0.04
EXTRACT	0.12	0.35	0.02	0.01	0.02	0.06	0.05	0.00	0.05
FOOD	0.19	0.01	0.26	0.02	0.00	0.01	0.02	0.00	0.04
LITMNFC	0.02	0.02	0.01	0.50	0.02	0.02	0.03	0.00	0.04
TECHMNFC	0.08	0.13	0.05	0.04	0.37	0.06	0.15	0.49	0.19
HVYMNFC	0.25	0.10	0.11	0.18	0.35	0.43	0.15	0.01	0.18
SVCES	0.24	0.40	0.19	0.21	0.24	0.41	0.61	0.51	0.46
Commodities	**0.46**	**0.60**	**0.80**	**0.67**	**0.58**	**0.65**	**0.46**	**1.00**	**0.58**

Table 6: Changes in Prices in South Africa after SEFTA1

Factors	%	Commodities	%
Land	-1.41	AGRIC	0.58
NatRes	0.33	EXTRACT	0.58
Capital	0.88	FOOD	0.64
UnskLab	0.94	LITMNFC	0.67
SkLab	0.95	TECHMNFC	0.69
		HVYMNFC	0.73
		SVCES	0.80
		CGDS	0.57

Table 7: Changes in Bilateral Trade

South Africa's Exports

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-2.10	-2.31	-2.20	-2.26
EXTRACT	-1.93	-2.62	2.46	-2.67
FOOD	-2.23	-2.62	-2.75	-2.68
LITMNFC	-3.73	-4.06	28.96	-3.94
TECHMNFC	-3.73	-4.25	18.86	-4.27
HVYMNFC	-1.96	-2.79	9.95	-2.86
SVCES	-3.08	-3.00	-2.92	-3.00

South Africa's Imports

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	1.24	1.20	1.20	1.19
EXTRACT	0.51	0.55	0.57	0.54
FOOD	1.18	1.29	1.29	1.29
LITMNFC	2.36	2.47	2.50	2.47
TECHMNFC	1.40	1.71	1.74	1.72
HVYMNFC	1.14	1.27	1.29	1.28
SVCES	1.68	1.61	1.61	1.61

European Union Exports

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	1.20	0.22	0.01	0.02	0.01
EXTRACT	0.57	0.81	0.04	-0.03	0.05
FOOD	1.29	0.51	0.05	0.01	0.01
LITMNFC	2.50	0.42	0.05	-0.07	0.03
TECHMNFC	1.74	0.62	0.06	-0.01	0.01
HVYMNFC	1.29	0.98	0.11	-0.02	0.03
SVCES	1.61	-0.07	0.01	0.01	0.01

European Union imports

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-2.20	0.06	0.02	0.02	0.01
EXTRACT	2.46	-0.09	-0.05	-0.03	-0.06
FOOD	-2.75	-0.11	-0.00	0.01	-0.00
LITMNFC	28.96	-0.20	-0.09	-0.07	-0.09
TECHMNFC	18.86	-0.35	-0.04	-0.01	-0.03
HVYMNFC	9.95	-0.18	-0.04	-0.02	-0.04
SVCES	-2.92	0.07	0.00	0.01	-0.00

Table 8: Estimated Changes in Quantities of EUNION Imports from SAFRICA

Sector	PE	GE
Agric	0.00	-2.2
Extraction	5.2	2.5
Food	0.00	-2.8
Litmnfc	28.9	29.0
Techmnfc	21.2	18.9
Hvymnfc	12.2	10.0
Svces	0.1	-2.9

Table 9: Change in Quantity of Imports into South Africa by Commodity and Origin (%)

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-1.43	1.24	1.20	1.20	1.19
EXTRACT	-2.49	0.51	0.55	0.57	0.54
FOOD	-1.71	1.18	1.29	1.29	1.29
LITMNFC	-2.01	2.36	2.47	2.50	2.47
TECHMNFC	-2.90	1.40	1.71	1.74	1.72
HVYMNFC	-1.87	1.14	1.27	1.29	1.28
SVCES	-1.45	1.68	1.61	1.61	1.61

Table 10: Summary of Welfare Decomposition[1]

	Allocative Efficiency	Terms of Trade	Total
SAFRICA	75	231	306
RESTSAF	-2	-16	-17
RESTSSH	-3	-5	-8
EUNION	-18	-113	-131
RESTWLD	-17	-98	-115
Total	35		35

[1]These figures are a translation of the welfare effects into 1995$m.
In technical terms, they measure the equivalent variation.

Table 11: Terms of Trade effects by Commodity and Region

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	9.35	-0.92	-0.25	-4.86	-3.33
EXTRACT	38.71	-0.55	-0.70	-21.09	-16.41
FOOD	7.08	-1.69	-0.55	-3.50	-1.36
LITMNFC	10.31	-0.61	-0.16	-7.56	-2.01
TECHMNFC	20.76	-5.46	-0.87	-17.74	3.25
HVYMNFC	62.91	-6.18	-2.02	-20.87	-33.91
SVCES	45.45	-0.71	-0.30	-19.98	-24.49
CGDS	37.16	0.14	0.08	-17.52	-19.88
Total	231.74	-15.98	-4.77	-113.11	-98.15

Table 12: Terms of Trade Decomposition for South Africa

	pworld	pexport	pimport	Total
AGRIC	0.04	9.23	0.05	9.32
EXTRACT	0.29	38.07	0.25	38.60
FOOD	-0.00	7.05	0.01	7.06
LITMNFC	0.00	10.27	0.01	10.28
TECHMNFC	0.21	20.36	0.13	20.70
HVYMNFC	0.09	62.32	0.32	62.73
SVCES	-0.02	45.12	0.23	45.32
CGDS	-0.07	37.13	-0.00	37.06
Total	0.53	229.54	1.00	231.07

Table 13: Terms of Trade Decomposition for EUNION

	pworld	pexport	pimport	Total
AGRIC	-1.10	-3.34	-0.42	-4.86
EXTRACT	-5.54	-10.57	-4.97	-21.08
FOOD	0.06	-5.52	1.96	-3.50
LITMNFC	0.24	-8.16	0.36	-7.56
TECHMNFC	-1.87	-21.56	5.69	-17.74
HVYMNFC	1.36	-41.32	19.09	-20.87
SVCES	0.13	-23.76	3.65	-19.98
CGDS	0.65	-18.17	-0.00	-17.52
Total	-6.07	-132.40	25.36	-113.11

Table 14: Welfare Decomposition by Commodity

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD	Total
AGRIC	0.29	0.15	0.34	-7.03	-6.21	-12.46
EXTRACT	0.92	-0.26	0.28	-0.97	3.67	3.62
FOOD	15.09	0.01	0.10	-7.38	-2.17	5.65
LITMNFC	20.78	-0.48	-0.42	-2.78	-2.08	15.01
TECHMNFC	30.91	-0.35	-1.73	0.62	-7.33	22.12
HVYMNFC	6.92	0.58	-1.19	1.16	0.61	8.09
SVCES	0.35	-1.24	-0.37	-1.96	-3.39	-6.61
Total	75.25	-1.59	-3.00	-18.35	-16.90	35.42

Table 15: Welfare Decomposition by Tax Type

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD	Total
prodtax	-0.08	0.39	0.18	-5.30	0.58	-4.23
inputtax	0.69	-1.24	-0.34	-0.67	-4.53	-6.10
finaldtax	24.10	-0.40	-0.27	-2.15	-2.84	18.45
xtax	1.17	-0.04	0.21	-1.63	0.20	-0.09
mtax	49.34	-0.23	-2.76	-8.28	-10.22	27.85
Total	75.23	-1.52	-2.99	-18.03	-16.81	35.89

Table 16: Welfare Decomposition for Light manufactures imports into the EUNION

	Welfare Contrib.	Change in Imp Vol.	Tariff Before	Tariff After
SAFRICA	4.6	213.9	4.5	-0.0
RESTSAF	-0.2	-2.2	9.5	9.5
RESTSSH	-0.0	-1.4	3.6	3.6
EUNION	0.0	-77.5	0.0	0.0
RESTWLD	-5.8	-84.3	6.9	6.9
Total	-1.4	48.5		

Table 17: Welfare Decomposition for Techmnfc imports into the EUNION

	Welfare Contrib.	Change in Imp Vol.	Tariff Before	Tariff After
SAFRICA	2.8	174.9	3.3	-0.0
RESTSAF	-0.0	-0.5	4.5	4.5
RESTSSH	-0.0	-0.2	3.2	3.2
EUNION	0.0	-61.4	0.0	0.0
RESTWLD	-3.1	-80.1	3.9	3.9
Total	-0.3	32.7		

Table 18: Welfare Decomposition for Hvymnfc imports into the EUNION

	Welfare Contrib.	Change in Imp Vol.	Tariff Before	Tariff After
SAFRICA	2.7	188.6	2.9	-0.0
RESTSAF	-0.0	-0.8	2.6	2.6
RESTSSH	-0.0	-0.4	3.1	3.1
EUNION	0.0	-86.4	0.0	0.0
RESTWLD	-1.5	-52.5	2.8	2.8
Total	1.2	48.6		

Table 19: Welfare Decomposition for Litmnfc imports into SAFRICA

	Welfare Contrib.	Change in Imp Vol.	Tariff Before	Tariff After
SAFRICA	0	-0.0	0	0
RESTSAF	1.3	3.1	40.9	40.9
RESTSSH	0.0	0.2	12.8	12.8
EUNION	3.7	11.6	31.6	31.6
RESTWLD	12.1	31.9	38.0	38.0
Total	17.0	46.8		

Tables Relating to SEFTA2

Table 20: Sectoral Output Changes by Region under SEFTA2 %

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	5.83	0.23	-0.02	-0.15	-0.00
EXTRACT	-2.34	0.06	0.02	0.02	0.02
FOOD	7.87	0.37	-0.02	-0.14	-0.01
LITMNFC	-1.26	-0.09	0.02	0.02	-0.00
TECHMNFC	-2.74	0.01	0.04	0.04	-0.00
HVYMNFC	-2.72	0.41	0.07	0.03	0.01
SVCES	0.16	-0.23	-0.00	0.00	-0.00
CGDS	3.73	-1.98	-0.06	-0.02	-0.02

Table 21: Price Changes under SEFTA2

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
Land	38.37	0.88	-0.14	-0.74	-0.01
UnskLab	3.19	-0.26	-0.04	-0.02	-0.00
SkLab	3.16	-0.45	-0.03	-0.01	-0.00
Capital	3.13	-0.33	-0.02	-0.02	-0.00
NatRes	-3.26	-0.04	0.05	0.04	0.05
AGRIC	5.66	0.08	-0.03	-0.08	-0.00
EXTRACT	1.43	0.03	0.01	-0.00	0.01
FOOD	3.26	0.20	-0.02	-0.05	-0.00
LITMNFC	2.37	0.09	-0.01	-0.02	-0.00
TECHMNFC	2.38	0.18	-0.01	-0.02	-0.00
HVYMNFC	2.53	0.14	-0.00	-0.02	0.00
SVCES	2.75	-0.03	-0.02	-0.02	-0.00
CGDS	1.95	0.18	-0.01	-0.02	-0.00

Table 22: Price and Output Changes in South Africa under SEFTA1 and SEFTA2

	PRICE CHANGES		OUTPUT CHANGES	
	SEFTA1	SEFTA2	SEFTA1	SEFTA2
Land	-1.41	38.37		
UnskLab	0.33	3.19		
SkLab	0.88	3.16		
Capital	0.94	3.13		
NatRes	0.95	-3.26		
AGRIC	0.58	5.66	-0.46	5.83
EXTRACT	0.58	1.43	-0.21	-2.34
FOOD	0.64	3.26	-0.12	7.87
LITMNFC	0.67	2.37	1.92	-1.26
TECHMNFC	0.69	2.38	-0.19	-2.74
HVYMNFC	0.73	2.53	-0.28	-2.72
SVCES	0.80	2.75	0.04	0.16
CGDS	0.57	1.95	1.01	3.73

Table 23: Changes in the Quantity of Imports into the European Union by Commodity and Origin (%)

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	52.81	-0.98	-0.54	-0.35	-0.66
EXTRACT	-1.44	-0.09	0.01	0.06	0.00
FOOD	319.52	-1.60	-0.70	-0.54	-0.77
LITMNFC	15.90	-0.71	-0.04	0.01	-0.12
TECHMNFC	6.88	-1.23	-0.05	0.01	-0.08
HVYMNFC	2.51	-0.59	-0.04	0.02	-0.05
SVCES	-9.79	0.10	0.02	0.03	-0.03

Table 24: Welfare Changes under SEFTA2 and SEFTA1

	SEFTA2			SEFTA1		
	Allocative Efficiency	Terms of Trade	Total	Allocative Efficiency	Terms of Trade	Total
SAFRICA	133	840	973	75	231	306
RESTSAF	-4	-54	-58	-2	-16	-17
RESTSSH	-9	-17	-26	-3	-5	-8
EUNION	167	-542	-374	-18	-113	-131
RESTWLD	-62	-238	-300	-17	-98	-115
Total	225	-11	214	35		35

Tables relating to SEFTA3

Table 25: Changes in Sectoral Output by Region under SEFTA3

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-0.09	0.12	0.01	-0.03	0.00
EXTRACT	0.90	0.10	-0.00	-0.04	0.00
FOOD	-0.12	0.15	0.01	-0.02	0.00
LITMNFC	-1.54	-1.62	-0.03	0.13	-0.03
TECHMNFC	-1.91	-0.35	-0.00	0.03	0.00
HVYMNFC	-0.10	0.06	0.00	-0.02	0.01
SVCES	0.27	0.05	-0.00	-0.00	-0.00
CGDS	5.00	-0.37	-0.04	0.00	-0.03

Table 26: Price Changes under SEFTA3

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
Land	-0.13	0.39	0.03	-0.11	0.01
UnskLab	0.32	-0.20	0.00	0.06	-0.01
SkLab	0.46	-0.20	-0.00	0.06	-0.01
Capital	0.31	-0.21	-0.00	0.05	-0.01
NatRes	2.80	0.21	-0.02	-0.05	-0.01
AGRIC	-0.06	-0.10	0.00	0.04	-0.01
EXTRACT	0.15	-0.03	-0.01	0.02	-0.01
FOOD	-0.09	-0.10	0.00	0.04	-0.01
LITMNFC	-1.71	-0.15	-0.00	0.04	-0.01
TECHMNFC	-0.59	-0.13	0.00	0.05	-0.01
HVYMNFC	-0.21	-0.11	-0.00	0.04	-0.01
SVCES	-0.03	-0.15	-0.00	0.05	-0.01
CGDS	-1.23	-0.12	0.00	0.04	-0.01

Table 27: Change in Quantity of Imports into the European Union under SEFTA3

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	0.32	0.54	0.09	-0.05	0.12
EXTRACT	4.55	0.09	-0.04	-0.16	-0.04
FOOD	0.56	0.60	0.16	-0.02	0.20
LITMNFC	50.28	1.08	0.09	-0.18	0.13
TECHMNFC	29.24	1.01	0.20	-0.09	0.26
HVYMNFC	14.27	0.56	0.11	-0.07	0.14
SVCES	0.36	0.70	0.15	-0.05	0.18

Table 28: Change in Quantity of Exports from the European Union under SEFTA3

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-0.46	-0.46	-0.13	-0.05	-0.17
EXTRACT	5.62	0.07	-0.07	-0.16	-0.11
FOOD	-0.46	-0.36	-0.13	-0.02	-0.19
LITMNFC	267.96	-2.35	-0.35	-0.18	-0.30
TECHMNFC	36.95	-1.08	-0.26	-0.09	-0.30
HVYMNFC	13.19	-0.61	-0.15	-0.07	-0.18
SVCES	-0.28	-0.48	-0.17	-0.05	-0.19

Table 29: Change in Quantity of Imports by South Africa under SEFTA3

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	0.09	-0.33	-0.46	-0.29
EXTRACT	0.08	-0.04	5.62	-0.04
FOOD	0.11	-0.29	-0.46	-0.25
LITMNFC	-41.37	-41.93	267.96	-41.90
TECHMNFC	-17.49	-18.15	36.95	-18.10
HVYMNFC	-6.80	-7.22	13.19	-7.19
SVCES	0.47	-0.08	-0.28	-0.05

Table 30: Change in Quantity of Exports from South Africa under SEFTA3

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-0.09	0.25	0.32	0.20
EXTRACT	-0.54	-0.66	4.55	-0.72
FOOD	0.22	0.43	0.56	0.38
LITMNFC	9.17	11.35	50.28	10.95
TECHMNFC	3.01	3.85	29.24	3.78
HVYMNFC	0.40	0.87	14.27	0.83
SVCES	-0.16	0.15	0.36	0.12

Table 31: Welfare Effects of SEFTA3

	Allocative Efficiency	Terms of Trade	Total
SAFRICA	-123	-153	-276
RESTSAF	-2	-4	-6
RESTSSH	4	-6	-2
EUNION	118	789	907
RESTWLD	-99	-626	-726
Total	-103	-0	-104

Table 32: Decomposition of South African Welfare Gains from Changes in Imports of Light Manufactures under SEFTA3

	welcnt	Dvol	taxrateb	taxrateu
SAFRICA	0	-0.0	0	0
RESTSAF	-22.3	-54.5	40.9	40.9
RESTSSH	-0.4	-3.3	12.8	12.8
EUNION	159.6	1245.2	31.6	0.0
RESTWLD	-205.8	-540.3	38.0	38.0
Total	-69.0	647.1		

Table 33: Decomposition of European Union Welfare Gains from Changes in Imports of Light Manufactures under SEFTA3

	welcnt	Dvol	Taxrateb	Taxrateu
SAFRICA	7.1	371.5	4.5	0.0
RESTSAF	1.1	11.5	9.5	9.5
RESTSSH	0.0	1.3	3.6	3.6
EUNION	0	-205.2	0	0
RESTWLD	8.3	120.5	6.9	6.9
Total	16.6	299.6	24.5	20.0

Tables Relating to SEFTA4

Table 34: Changes in Sectoral Output by Region under SEFTA4

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	6.07	0.27	-0.02	-0.17	-0.00
EXTRACT	-0.99	0.15	0.02	-0.02	0.01
FOOD	7.11	-0.19	-0.03	-0.11	-0.01
LITMNFC	-4.60	-1.69	-0.00	0.17	-0.03
TECHMNFC	-4.29	-0.31	0.04	0.06	0.00
HVYMNFC	-2.32	0.36	0.06	0.01	0.02
SVCES	0.36	-0.09	-0.00	-0.00	-0.00
CGDS	7.52	-1.78	-0.08	-0.02	-0.04

Table 35: Price Changes under SEFTA4

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
Land	38.89	0.97	-0.13	-0.77	-0.04
UnskLab	2.33	-0.41	-0.04	0.05	-0.01
SkLab	2.42	-0.54	-0.03	0.05	-0.01
Capital	2.32	-0.46	-0.02	0.04	-0.01
NatRes	-0.39	0.22	0.04	-0.01	0.03
AGRIC	4.65	-0.08	-0.04	-0.03	-0.02
EXTRACT	0.89	-0.02	0.00	0.02	-0.00
FOOD	1.88	0.02	-0.02	-0.00	-0.01
LITMNFC	-0.26	-0.11	-0.02	0.03	-0.01
TECHMNFC	0.90	-0.03	-0.01	0.04	-0.01
HVYMNFC	1.36	-0.05	-0.01	0.04	-0.01
SVCES	1.69	-0.20	-0.02	0.04	-0.01
CGDS	-0.02	-0.02	-0.01	0.04	-0.01

Table 36: Change in Quantity of Imports into the European Union under SEFTA4

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	58.82	-0.22	-0.41	-0.44	-0.49
EXTRACT	1.07	0.14	0.02	-0.09	0.03
FOOD	345.84	-0.67	-0.51	-0.59	-0.55
LITMNFC	36.92	0.77	0.19	-0.12	0.13
TECHMNFC	17.57	0.34	0.24	-0.08	0.24
HVYMNFC	7.44	0.31	0.14	-0.04	0.14
SVCES	-5.97	0.88	0.20	-0.04	0.17

Table 37: Change in Quantity of Exports from the European Union under SEFTA4

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	51.31	1.69	0.06	-0.44	0.09
EXTRACT	5.47	1.05	-0.03	-0.09	-0.08
FOOD	110.15	1.32	0.07	-0.59	-0.04
LITMNFC	276.23	-1.46	-0.26	-0.12	-0.24
TECHMNFC	41.69	0.21	-0.16	-0.08	-0.28
HVYMNFC	15.58	1.45	0.07	-0.04	-0.12
SVCES	3.22	-0.66	-0.17	-0.04	-0.16

Table 38: Change in Quantity of Imports by South Africa under SEFTA4

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	13.81	13.62	51.31	13.53
EXTRACT	-0.09	-0.19	5.47	-0.18
FOOD	-12.36	-12.23	110.15	-12.25
LITMNFC	-40.26	-40.60	276.23	-40.63
TECHMNFC	-15.20	-15.29	41.69	-15.29
HVYMNFC	-5.10	-5.26	15.58	-5.26
SVCES	4.17	3.47	3.22	3.44

Table 39: Change in Quantity of Exports from South Africa under SEFTA4

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-15.45	-16.85	58.82	-16.54
EXTRACT	-2.97	-3.92	1.07	-4.06
FOOD	-6.50	-7.50	345.84	-7.67
LITMNFC	0.34	1.56	36.92	1.51
TECHMNFC	-5.12	-5.43	17.57	-5.52
HVYMNFC	-3.79	-5.07	7.44	-5.24
SVCES	-6.65	-6.18	-5.97	-6.18

Table 40: Welfare Effects of SEFTA4

	alloc_A1	tot_E	Total
SAFRICA	-63.7	401.3	337.5
RESTSAF	-5.1	-41.8	-46.9
RESTSSH	-2.3	-19.5	-21.7
EUNION	221.1	480.7	701.8
RESTWLD	-131.0	-823.3	-954.3
Total	19.0	-2.6	16.4

Table 41: Decomposition of South African Welfare Gains from Changes in Imports of Light Manufactures under SEFTA4

	welcnt	dvol	taxrateb	taxrateu
SAFRICA	0	-0.0	0	0
RESTSAF	-21.6	-53.0	40.9	40.9
RESTSSH	-0.4	-3.2	12.8	12.8
EUNION	162.5	1283.7	31.6	0.0
RESTWLD	-198.2	-523.9	38.0	38.0
Total	-57.7	703.4		

Table 42: Decomposition of European Union Welfare Gains from Changes in Imports of Light Manufactures under SEFTA4

	welcnt	dvol	taxrateb	Taxrateu
SAFRICA	5.6	272.7	4.5	-0.0
RESTSAF	0.8	8.3	9.5	9.5
RESTSSH	0.1	2.7	3.6	3.6
EUNION	0	-137.6	0	0
RESTWLD	8.2	118.6	6.9	6.9
Total	14.7	264.6		

Tables relating to SEFTA6

Table 43: Changes in Sectoral Output by Region under SEFTA6

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	-0.21	-1.79	0.01	0.03	0.01
EXTRACT	-0.62	-1.86	0.00	0.01	0.01
FOOD	0.27	-0.68	-0.00	-0.00	-0.00
LITMNFC	0.49	28.95	-0.04	-0.04	-0.03
TECHMNFC	0.46	0.40	-0.01	-0.00	-0.00
HVYMNFC	-0.19	-3.50	0.00	0.00	0.00
SVCES	-0.01	-0.31	-0.00	-0.00	-0.00
CGDS	1.11	15.15	-0.02	-0.01	-0.01

Table 44: Price Changes under SEFTA6

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
Land	-0.28	-4.06	0.06	0.17	0.04
UnskLab	0.79	5.15	0.01	-0.00	-0.00
SkLab	0.79	5.39	0.00	-0.00	-0.00
Capital	0.78	5.05	0.01	-0.00	-0.00
NatRes	-0.91	-3.07	0.02	0.02	0.03
AGRIC	0.53	2.49	0.01	0.01	0.01
EXTRACT	0.29	0.49	0.01	0.01	0.01
FOOD	0.48	1.51	0.01	0.01	0.00
LITMNFC	-0.38	0.37	0.01	0.00	-0.00
TECHMNFC	0.53	1.20	0.01	0.00	-0.00
HVYMNFC	0.56	1.43	0.01	0.00	-0.00
SVCES	0.64	2.70	0.01	-0.00	-0.00
CGDS	0.43	0.96	0.01	0.00	-0.00

Table 45: Change in Quantity of Imports into the Rest of Southern Africa under SEFTA6

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	11.56	11.34	5.52	5.52	5.54
EXTRACT	14.56	10.36	-6.28	-6.26	-6.26
FOOD	27.64	33.33	-5.01	-4.99	-4.97
LITMNFC	254.23	229.03	-9.11	-9.07	-9.06
TECHMNFC	31.76	27.94	-0.75	-0.69	-0.68
HVYMNFC	16.20	13.44	-5.06	-5.03	-5.02
SVCES	5.22	-3.86	5.92	5.95	5.96

Table 46: Change in Quantity of Exports from the Rest of Southern Africa under SEFTA6

	SAFRICA	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	21.23	11.34	-9.55	-9.64	-9.30
EXTRACT	27.88	10.36	-2.17	-2.32	-2.33
FOOD	63.43	33.33	-6.17	-6.16	-6.24
LITMNFC	643.00	229.03	-2.31	-2.36	-2.34
TECHMNFC	95.51	27.94	-7.23	-7.25	-7.31
HVYMNFC	16.13	13.44	-5.24	-5.47	-5.63
SVCES	-8.55	-3.86	-9.65	-9.67	-9.67

Table 47: Change in Quantity of Imports by South Africa under SEFTA6

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	21.23	-0.14	-0.13	-0.11
EXTRACT	27.88	-0.24	-0.22	-0.21
FOOD	63.43	-0.23	-0.20	-0.19
LITMNFC	643.00	-24.61	-24.58	-24.57
TECHMNFC	95.51	1.19	1.25	1.26
HVYMNFC	16.13	0.88	0.91	0.92
SVCES	-8.55	1.21	1.24	1.25

Table 48: Change in Quantity of Exports from South Africa under SEFTA6

	RESTSAF	RESTSSH	EUNION	RESTWLD
AGRIC	11.56	-2.01	-1.86	-2.00
EXTRACT	14.56	-1.27	-1.29	-1.30
FOOD	27.64	-1.91	-2.03	-1.99
LITMNFC	254.23	2.43	2.45	2.32
TECHMNFC	31.76	-3.28	-3.34	-3.32
HVYMNFC	16.20	-2.12	-2.18	-2.20
SVCES	5.22	-2.37	-2.39	-2.39

Table 49: Comparison of Impacts on Volumes of Trade of Two FTAs (1995$m)

	South Africa				Rest of Southern Africa			
	Imports		Exports		Imports		Exports	
SA joins FTA with:	EU	REST SAF	EU	REST SAF	EU	REST SAF	European Union	REST SAF
AGRIC	146	19	378	-15	-11	41	14	-136
EXTRACT	20	1	-106	-70	-2	12	4	-58
FOOD	419	26	1457	60	-7	54	-6	32
LITMNFC	632	408	267	365	-12	295	-41	837
TECHMNFC	1839	227	45	199	-31	258	-9	48
HVYMNFC	346	58	-218	-18	-17	106	2	-72
SVCES	220	80	-237	-89	-16	156	13	-155
Total	3621	818	1586	431	-96	923	-22	496

Table 50: Welfare Effects of a SA-SADC FTA

	Allocative Efficiency	Terms of Trade	Total
SAFRICA	18.1	146.2	164.3
RESTSAF	15.7	154.2	169.9
RESTSSH	-2.1	-0.2	-2.3
EUNION	-68.7	-87.8	-156.5
RESTWLD	-43.3	-213.7	-257.0
Total	-80.3		-81.6

Table 51: Decomposition of Rest of Southern African Welfare Gains from Changes in Imports Heavy Manufactures under a SA-SADC FTA

	Welcnt	Dvol	taxrateb	taxrateu
SAFRICA	4.0	161.5	5.3	0.0
RESTSAF	0.3	10.6	5.5	-0.0
RESTSSH	-0.1	-1.2	7.0	7.0
EUNION	-3.2	-29.4	11.1	11.1
RESTWLD	-2.3	-28.7	8.1	8.1
Total	-1.3	112.8		

Table 52: Decomposition of South African Welfare Gains from Changes in Imports of Light Manufactures under a SA-SADC FTA

	Welcnt	dvol	taxrateb	Taxrateu
SAFRICA	0	-0.0	0	0
RESTSAF	118.3	847.1	40.9	0.1
RESTSSH	-0.3	-2.0	12.8	12.8
EUNION	-36.0	-114.2	31.6	31.6
RESTWLD	-120.2	-316.9	38.0	38.0
Total	-38.1	414.0		

APPENDIX I: Commodity Aggregations

AGRIC:	Paddy rice, Wheat, Cereal grains nec, Vegetables, fruit, nuts, Oil seeds, Sugar cane, sugar beet, Plant-based fibers, Crops nec, Bovine cattle, sheep and goats, horses, Animal products, Raw milk Wool silk-worm cocoons, Bovine cattle, sheep and goat, horse meat prods,
FOOD:	Meat products nec, Vegetable oils and fats, Dairy products, Processed rice, Sugar, Food products nec, Beverages and tobacco products
EXTRACT:	Forestry, Fishing, Coal, Oil, Gas, Minerals nec, Petroleum, coal products
LITMNFC:	Textiles, Wearing apparel, Leather products, Wood products,
HVYMNFC:	Paper products, publishing, Chemical, rubber, plastic products, Mineral products nec, Ferrous metals, Metals nec,
TECHMNFC:	Metal products, Motor vehicles and parts, Transport equipment nec, Electronic equipment, Machinery and equipment nec, Manufactures nec
SVCES:	Electricity, Gas manufacture, distribution, Water, Construction Trade, transport, Financial, business, recreational services, Public admin and defence, education, health, Dwellings & Svces

APPENDIX 2: Description of Simulations

SEFTA 1 implements part (namely removal of EU import tariffs on South African goods excluding agriculture and food) of a FTA between South Africa and the European Union.

SEFTA2: implements part (namely removal of all EU import tariffs) of a FTA between South Africa and the European Union.

SEFTA3 implements part (namely bilateral removal of tariffs on all goods excluding agriculture and food) of a FTA between South Africa and the European Union.

SEFTA4 implements part (namely bilateral removal of all tariffs) of a FTA between South Africa and the European Union.

SEFTA5 implements all (namely bilateral removal of all tariffs and export subsidies) of a FTA between South Africa and the European Union.

SEFTA6 implements a FTA between South Africa and the rest of southern Africa (removal of import tariffs only, including those on intra regional trade). No EU FTA occurs.

SEFTA7 implements two FTAs: between South Africa and the rest of southern Africa, and between South Africa and the EU (both involve removal of import tariffs only). The SA-EU FTA doesn't include agriculture.

SEFTA8 implements two FTAs: between South Africa and the rest of southern Africa, and between South Africa and the EU (both involve removal of import tariffs only). The SA-EU FTA includes agriculture.

Trade instrument removed	Experiment #							
	1	2	3	4	5	6	7	8
Non-agricultural import tariffs from SAFRICA to EU	x	x	x	x	x		x	x
Agricultural import tariffs from SAFRICA to EU		x		x	x			x
Non-agricultural import tariffs from EU to SAFRICA			x	x	x		x	x
Agricultural import tariffs from EU to SAFRICA				x	x			x
Non-agricultural export subsidies from SAFRICA to EU					x			
Agricultural export subsidies from SAFRICA to EU					x			
Non-agricultural export subsidies from EU to SAFRICA					x			
Agricultural export subsidies from EU to SAFRICA					x			
Import tariffs from RESTSAF to SAFRICA						x	x	x
Import tariffs from SAFRICA to RESTSAF						x	x	x

EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH
TRADE REGIMES AND GROWTH

Increasing Employment and Labour Productivity in South Africa

Progress Report

February 5, 1998

Project Principal Investigator: J. Dirck Stryker
South African Principal Investigator: Fuad Cassim
South African Associate Investigators: Haroon Bhorat and Bala Rajaratnam

Objectives

The objective of this study is to analyze the factors influencing the demand for labour in South Africa and how this demand is related to the determinants of labour productivity. The study is examining employment in different sub-sectors of the economy; the influence on employment of alternative rates and patterns of growth; how employment is related to such variables as firm size, export orientation, degree of unionization, and centralized collective bargaining; and what the impact would be of different strategies for growth and employment.

Research Questions

The research is designed to answer a number of research questions regarding labour employment in South Africa, particularly among unskilled and semi-skilled Black workers.

1. Why has the rate of growth of employment declined or even become negative over the past few years in contrast to the period from 1970 to 1989, despite continued growth of GDP, albeit at a very moderate pace? To what extent is this due to the changing industrial structure of the economy, to a pattern of incentives that favors less labour-intensive larger firms, to a shedding of labour by firms trying to become more competitive in South Africa's liberalized economy, or to a decline in the quality of the work force?

2. What factors are responsible at the firm level of higher or lower levels of employment? To what extent is employment influenced by
   a. Plant size (measured by sales or value added);
   b. Age of the establishment;
   c. South African versus foreign ownership;
   d. Orientation towards foreign as opposed to domestic markets;
   e. Wage rates paid;
   f. Benefit package;
   g. Expenditure on training;
   h. Occupational and racial structure of employment;
   i. Practices regarding use of shifts and payment of overtime;

j. Innovations in product range, new technology, or management;
k. Company restructuring;
l. Capacity utilization;
m. System of work organization;
n. Quality of the work force;
o. Degree of Unionization;
p. Industry subject to a bargaining council agreement;
q. Existence of a collective labour agreement and extent of its coverage;
r. Industrial disputes;
s. Use of temporary, casual, contractual, or part-time workers;
t. Investment in capital stock..

Research Approach

The research approach followed in this study involves the following steps.

1. Assessment of Trends in Employment. This step comprises the use of data from Central Statistical Services (CSS) and the WEFA Group on output, employment, and other variables broken down by 43 subsectors to analyze the existing structure and trends in employment. Preliminary processing of these data has already been undertaken. The quality of and biases in the data are being assessed in light of the analysis in the recent International Labour review and the attempt by Ntsika to estimate recent trends in the growth of small business in South Africa.[1] The sub-sector breakdown of the employment data will be matched with the input-output table maintained by Ntsika in order to estimate direct and the indirect employment coefficients resulting from changes in the level of output. These will then be used to track historical changes in the subsector and firm-size composition of employment given changes during the recent past in the structure of the economy. Alternative growth and employment strategies will also be examined to see how these will impact employment in the future. Special attention will be paid to strategies oriented towards small versus large firms.

2. Pooled Cross-Section, Time-Series Estimation. The annual subsector data from 1970 to 1995 are also being used to estimate pooled cross-section, times-series labour demand functions, where independent variables include the level of real output, real value added, real fixed capital stock, real wages, the ratio of imports to domestic demand, and the ratio of exports to total output. Fixed, industry-specific effects are taken into account through the use of dummy variables. In addition, an attempt is being made to estimate labor demand functions using quarterly data from the manpower survey from 1988 to 1996.

3. Analysis of the South African Labour Flexibility Survey. Multivariate analysis is being undertaken of the most recent South African Labour Flexibility Survey (SALFS2) to estimate the influence on employment of such factors as firm size, capacity utilization, export orientation, wage and fringe benefits, use of temporary workers and subcontracting, formal training, number of shifts, product and process innovations, unionization, and

[1] Guy Standing, John Sender, and John Weeks, *Restructuring the labour market: The South Africa challenge*, an ILO Country Review, Geneva: International Labour Office: 1996; Ntsika, *The State of Small Business in South Africa*, Pretoria: 1997.

coverage by an industrial council agreement. This analysis will be used to estimate the changes in the coefficients calculated in Step 1 that would result from changes in the explanatory variables, including those induced by policy reform.

4. Analysis of the Impact of Government Policy. The results of the preceding analysis will be used to assess the impact of government policy on employment and labor productivity. Examples of such policy include the Labour Relations Act and the Basic Conditions of Employment Act.

Preliminary Results

Although it is too early to provide any definitive conclusions of the study, preliminary results of the analysis of the SALFS2 data suggest the importance of formal training, wages and benefits, and export orientation in the demand by firms for labour, including African unskilled and semi-skilled labour. Thus, for example, with sales held constant, the elasticity of total employment and of employment of unskilled and semi-skilled African workers with respect to expenditures on training is anywhere from 0.14 to 0.38, depending on the specification of the model. The relationship is highly significant. This is especially pertinent in that these expenditures are generally very low in relation to the wage bill. Thus a relatively small increase in the absolute level of expenditures on training could have a very significant impact on employment.

There is a slight tendency for firms that are export-oriented to employ more labour, with sales held constant, though this relationship is not always significant. This raises questions regarding the common assumption that expansion of South Africa's exports has been primarily in relatively capital-intensive processing of minerals and other primary products. The results are too preliminary, however, to be more than suggestive at this time.

Average wages were calculated by dividing the entire wage bill by total employment in each firm. Average remuneration was calculated in a similar way by dividing total wages and benefits by total employment. This is only a first approach, however, since these calculations ignore differences in the occupational structure of the labour force across firms. An alternative variable -- the ratio of the benefits bill to the wage bill -- avoids this problem to the extent that this ratio is not dependent on occupation.

Average wages, average remuneration, and the ratio of benefits to wages all have a highly significant negative impact on employment, with elasticities of total employment and of employment African unskilled and semi-skilled workers with respect to wages and total remuneration of anywhere from -0.66 to -0.85. These estimates are relatively close to the average wage elasticity estimates for all industries from the 1993 SALDRU household survey of approximately -0.71. However, the failure to account at this time for variations in skill levels across industries implies that there is some degree of error-in-variables bias. What effect this has on the estimates will only be determined after we have taken into account these skill differences.

Variables that do not appear to have any effect on employment are ownership and age of the firm. The other variables listed above have not yet been tested.

Timing of Future Reports

Except for the manpower survey data, all data have been obtained and the analysis outlined in Steps 1 through 3 is well underway. Preliminary results will be presented at the next EAGER workshop in July 1998. The analysis of government policy will be undertaken as these preliminary results become available. The final report will be prepared and circulated to the South Africa EAGER Steering Committee for comment prior to being presented at the EAGER African Conference in early 1999.

Macroeconomic Policy and the Labour Market

Macroeconomic Policy

To be incorporated later

Labour Market

The key pieces of legislation regulating the labour market, that are of particular relevance to current state of the labour market are the Basic Conditions of Employment Act(BCEA),the Labour Relations Act and the Wage Act.

Basic Conditions of Employment Act

The BCEA sets minimum standards for a wide variety of employment issues and at the same time it is subject to many exclusions. It does not set minimum wage rates but emphasis is laid on work related issues, such as, working hours,maternity leave,serverence entitlements, continuous work and Sunday working. The key aim being to set employment standards legislation.

One of the most contentious issues has been the proposal to limit the working week to 40 hours. The ILO has argued that SA's average working week of 45 hours is out of line with other countries and that there is evidence to indicate that shortening the working week toby legal means would raise the level of employment. The ILO argues that the BCEA is not sufficiently inclusive and therefore regulatory protection which it was designed for may weaken.

Labour Relations Act

The Labour Relations Act (LRA) is particularly important for wage determination since it institutionalises collective bargaining through industrial councils. The Labour Relations Act provides for the establishment of sectoral industrial councils, which can negotiate wages and conditions of employment, for an industry providing that the parties are sufficiently representative of the industry or area. New parties can join a council if the existing parties agree. Council agreements are binding on parties and are extended to non parties within the same industry. From the perspective of the participants the provision for "extensions" are necessary to prevent unfair competition through undercutting by those not party to an agreement.

The main concern with the industrial council system is that industry level wage setting allows large firms to restrict entry by fixing the wages that entry level firms have to pay and this allows large firms and unions to share monopoly ranks at the expense of job creation and increased output (for a formal exposition of this view see Moll). The ILO does not support this view instead argues that the IC's do not have any anti-competitive influence in that the firms pay wages above the minimum defined by IC rulings. An alternative explanation could be that unions set wages at a premium above the IC minimum, which if it is already above the market clearing wage could result in a significant wage premia.

The Wage Act

The main objective of the Wage Act is to determine minimum wages in areas not covered by the LRA. In 1995 there were 19 orders in place covering 727,736 workers, of which over half were covered by a wage order obtained for the Commercial Distributive Trade for Certain Areas. A comparison between wage median wages[1] set under wage boards and Industrial Councils between 1973 and 1988 showed that wages established under this act were lower than the IC settlements, and had declined from an average of 89% of the IC median to 56% in 1988, due to the infrequency of revisions to statutory minima.

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[1] Horner, D., 1994: "Reconstituting the Wage Board: Rescue and Resuscitation", paper delivered to the Seventh Annual Labour Conference, 1994.

Project EAGER/PSGE
Equity and Growth through Economic Research in Africa
Public Sector for Growth with Equity

The Impact of Financial Sector Reform on Bank Efficiency and Financial Deepening for Savings Mobilization in Ghana

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A Preliminary Report Presented at the USAID EAGER Workshop in Johannesburg, South Africa, February 4 - 6, 1998

I. Summary of principal themes and anticipated policy implications

1.1 Introduction

Over the past decade, many Sub-Sahara African countries have embarked on structural adjustment programs designed to reverse their poor economic performance. In all, 19 Sub-Sahara African countries have made serious efforts to transform their economies to a market based economic system while 15 other countries adopted some limited form of structural adjustment programs.[1] However, many of these countries realized that their structural adjustment programs could not succeed without a well functioning financial sector for the mobilization of financial resources for investment and private sector growth.

Ghana is one of those countries that had undergone structural adjustment and financial sector reform designed to enhance the savings mobilization and credit allocation to the private sector. Ghana's case was unique for several reasons: First, Ghana was the first Sub- Sahara African country to gain political independence from the British colonial rule in March 7, 1957. Secondly, at the time of independence, Ghana was the richest country among the Sub-Sahara African countries outside South Africa; its per capita income compared favorably with that of South Korea. Yet Ghana experienced the sharpest economic decline which had also destabilized its financial sector in the 1970s and 80s. Also Ghana became the first Sub-Sahara African country to formulate a comprehensive financial sector reform to deregulate the financial markets from decades of government intervention in order to enhance savings mobilization and credit allocation to the private sector for growth.

However, a decade after the financial sector reform, critics argue that the financial sector reform did not result in increased savings mobilization and credit allocation to the private sector. Instead, it led to a macroeconomic imbalance of high inflationary pressures, high nominal interest rates. and continuous devaluation of the local currency.

1.2. The Objective of the Study

The objective of this study is to examine, in detail, the institutional and policy changes that were initiated in the financial sector reform in Ghana in the late 80's and early 90's. Secondly, the study will examine the impact of the financial sector reform on the efficiency of savings mobilization and credit allocation to the private sector. The study will analyze some of the existing problems after the financial sector reform and what further adjustment efforts may be needed. On a micro level, the study will construct an index of banking efficiency and bank performance for comparative analysis of the banking sector in Ghana. We will also examine the efficacy of existing prudential regulations and bank supervision in promoting banking efficiency, soundness, and safety. In addition, this study may draw lessons from Ghana's experience that may be applicable to other African countries that may be facing similar problems.

Based on the results of the above analysis, relevant policy recommendation will be offered

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[1]V.V. Bhatt, On Financial Sector Reform and Development: A Case Study of Ghana, African Review of Money, Finance and Banking, Volume 1 (1993), p. 5.

to promote banking efficiency and financial deepening for savings mobilization and growth with poverty alleviation.

1.3. Organization of the Study

The organization of this preliminary report is as follows: Section II discusses the characteristics of the Ghanaian financial sector before the financial sector reform. It also discusses the research questions that will be addressed in this study. Section III undertakes a discussion of the highlights of the provisions of the financial sector reform and its implementations. The methodology of this study has been discussed in section four. The preliminary findings are discussed in section 5. Section six discusses the policy implications and preliminary recommendations of the study.

II. The characteristics of the Ghanaian Financial Sector Before the Financial Sector Reform

The financial system of Ghana has been characterized by excessive regulation by the government, underdevelopment of the financial sector and encroachment on the authority of the Bank of Ghana. Unlike the U.S., where the chairman of the Central Bank, known as the Federal Reserve System is nominated by the President and confirmed by the Senate, in Ghana, the governor of the Bank of Ghana is directly appointed by the President, and serves at the pleasure of the government. Thus, even though in principle, the Bank of Ghana is supposed to be independent of the government, in practice, the operations of the Bank are not insulated from the political pressures from the government. This non-independence of the Bank manifests in the government's treatment of the Bank as an extension of the Ministry of Finance in carrying out the economic objectives of the government. Thus, the functions of the Bank are carried out in consultation with the government. This practice has compromised the autonomy and neutrality of the Bank of Ghana as a monetary control institution for the stabilization of the nation's economy.

Unlike the U.S. financial system, characterized by private ownership of financial institutions, all financial institutions, with the exception of two foreign majority-owned banks, were owned by the government. This led to a lack of competitive environment, market inefficiencies and political patronage in the banking system. In addition, since managers of these institutions do not share any risk of loss, they have a propensity to take on additional risk without paying any price for their actions.

A major consequence of government's ownership of the banking institutions is the control and regulation of interest rates which distorts the allocative function of interest rates in any market economy. In order to lower the cost of borrowing to consumers, the business community, government and non-government agencies, the government imposed ceiling on commercial bank lending/borrowing and deposit rates. Consequently, with inflation running at double or triple digits,[2] the real rate of interest was negative in the 1970's and 80's. As a result, many potential

[2]Three times in the Ghanaian history, inflation reached over 100% in 1987, 1981 and 1983. Other times it stayed in double digits.

savers refrained from saving in the banking system. This led to excess liquidity outside the banking system which fueled inflation and further weakened the monetary control powers of the Bank of Ghana.

In addition, the low lending rates provide no incentive for commercial banks to lend money to the private sector. This resulted in large excess liquidity in the banking system. In view of the large excess liquidity in the baking system and since banks would have to pay interest on savings accounts, the commercial banks were discouraging potential depositors from opening savings accounts. Customers were encouraged to open checking accounts which do not attract interest payments.[3] The effect was to decrease private savings and encourage excessive aggregate demand which fueled inflation.

As a means of controlling aggregate money supply, the Bank of Ghana imposed credit ceilings on bank lending to the private sector. This instrument has become the predominant monetary control policy instrument of the Bank of Ghana. However, critics argue that this policy has an unintended negative impact on the banking sector. This policy led to excess reserves in the banking system, lack of competition, resource misallocation and inhibited the development of an efficient money market in Ghana.

A major feature of the Ghanaian financial system is the excessive borrowing by the government from the banking institutions. In order to induce the banking sector to provide loans to the government to cover its budget deficits, commercial banks were permitted to include short-term government treasury bills as part of their short-term liquid assets that could satisfy their cash reserve requirements. As a result, many commercial banks preferred to hold large portfolios in government short-term Treasury bills and very little assets in private business loans. This deprived small and medium-size enterprises of financial capital for business expansion.

Unlike the U.S. where commercial banks, savings and loans and saving banks are required to be covered by one of many insurance funds, there is no insurance fund to cover commercial banks and savings and loans in Ghana. Consequently, the government as the owner of commercial banks and savings and loans has to cover the risk of loss for any insolvent financial institutions.

One of the cornerstones of a market economy is an efficient capital market that facilitates the accumulation of financial capital for business expansion. Unlike the U.S. which can boast of a well developed capital market, the Ghanaian financial system lacks a well developed capital market as a means whereby surplus funds from investors can be pulled into productive investment opportunities.

A World Bank study of the Ghanaian banking sector (1988) concludes that the banking sector was characterized by (1) inefficiency and high operating costs, (2) huge non-performing loan portfolios, (3) inadequate provision for loan loss, (4) insolvency of the banking system, (5) capital inadequacy, and (6) inflated profits[4]. The study also shows that the banking sector had deteriorated

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[3]The principal investigator, while on a visit to Ghana in 1980, was denied an application to open a savings account at Standard Chartered Bank in Accra. The bank official tried to convince the investigator to open a checking account which does not attract deposit interest payment by the bank. The official explained that because of interest rate control, the bank could not earn enough interest on loans to pay interest on savings accounts by bank depositors.

[4] The World Bank, Ghana Financial Sector Adjustment Program, May 1988.

as a result of the general economic decline during the 1970s and early 1980s.

Others argue that the inefficiency of deposit mobilization by the banking system may be attributed to the inferior quality of customer services of a number of commercial banks. In addition, there is limited scope of financial instruments and banking services which could not encourage increased savings mobilization. It is also argued that banks in general find it unnecessary to innovate if they do not face any stiff competition from within or from outside. This lack of effective competition may be the result of the continued state ownership of commercial banks[5] in Ghana.

Another factor that may account for the low saving in the Ghanaian financial sector is the lack of confidence in the banking system. This is due to the inefficiency of the banking system and the ad hoc measures taken by the government in violation of the confidentiality of individual banking accounts. In 1987, the government passed the infamous AFRC decree 17 which allowed the government to have access to individual bank accounts without the knowledge of the individual bank account holder. As a result, many individual depositors pulled their savings from the banking sector for fear that the government might question them about the sources of their savings.

The inconvenience of banking hours has also contributed to financial disintermediation from the banking sector. In a survey by Aryeetey and Gockel (1989), they found that regular banking hours are not convenient for market women; many of them prefer to save with informal savings institutions. The same complaint is often heard from office workers about the inconvenience of the traditional banking office hours. Thus, a change in the banking hours or addition of weekend banking hours may be necessary to attract more people to put money in the banking system. However, official banking hours are regulated by the Bank of Ghana (BOG). Consequently, the banks are required to obtain permission from the BOG before changing their working hours to suit the convenience of the bank customers. This restriction limits the ability of the banks to respond to the needs of the bank customers in terms of convenient banking hours.

The lack of adequate prudential regulatory enforcement and supervision of commercial banks has been a major cause of the problems of the banking sector in Ghana in the 1970s and early 1980s. In the absence of vigorous enforcement of prudential regulations and bank supervision, less attention was paid to the provision of required reserve and capital requirements. The consequence has been the insolvency of many banks in Ghana and other SSA countries.

A World Bank Development Report (1989) indicates that regulation and bank supervision in developing countries should emphasize compliance with monetary policy and foreign exchange guidelines. In addition, the goal of bank supervision should encourage the promotion of safety, stability, and efficiency of the banking sector.

The efficiency in operation of the banking system is also constrained by technological underdevelopment of the Ghanaian economy and information asymmetry (limited information.) Unlike the U.S. where automation and the use of computers have increased the productivity and efficiency of bank employees, the production of banking services in Ghana is labor intensive; bank ledgers, customer accounts, and other records are processed by hand. This leads to low productivity, under-utilization of human capital, and inefficient operation in the banking sector. In view of the inefficiencies of the banking system, which results in a considerable amount of waiting time at the banks, a large section of the Ghanaian population prefers to hold liquid cash outside the banking

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[5] The Ghana Commercial Bank, the largest commercial bank is being privatized.

system.

Others argue that the macroeconomic imbalance of high inflation as the result of continuous government budget deficit discourages the public from holding financial assets and increased savings in the banking system. This resulted in large currency holdings and savings outside the banking sector and the creation of a booming informal sector. A recent World Bank study (1994) concludes that Ghana has the potential of growing faster if policies are designed to improve the efficiency of savings mobilization through the banking system accompanied by efficient allocation of resources to the productive sectors of the economy. It was estimated that by channeling about 16 percent of savings which is currently held outside the banking sector into the banking system, there is the potential for raising economic growth and poverty reduction by one percentage point (World Bank, 1994).

By 1983, the economy of Ghana was at a state of total collapse. In April of 1983, the government, in collaboration with the World Bank and the International Monetary Fund (IMF), embarked on a comprehensive economic recovery program (ERP) to reverse Ghana's poor economic performance. The various policy initiatives include a massive devaluation of the Ghanaian currency, removal of controls on foreign exchange transactions, decontrol of domestic prices and other measures to increase the free market system in Ghana. One significant impact of the macroeconomic policy change in 1983 was the reduction of the inflation rate from over 100 percent in the 1970s and early 80s to 10 percent in 1991. This policy change was also accompanied by growth in GDP.

However, despite these successful policy changes, the financial sector remained weak and could not mobilize significant resources to sustain the economic reform program. By 1987, the cumulative effect of the record devaluation, excessive regulation of commercial banks, market inefficiencies, and heavy losses by the banking sector resulted in financial crisis in the banking sector. The severe losses suffered by the commercial banks had pushed many of them to a state of bankruptcy or technical insolvency[6].

Since the majority of the troubled banks were owned by the government, and in the absence of a private banking insurance, the government had to absorb all losses suffered by the banking sector in order to prevent runs on the banks.

In response to the financial crisis in the banking sector, the government of Ghana in collaboration with the World Bank and the IMF embarked on a comprehensive financial sector reform known as the Financial Institutions' Sector Adjustment Program, hereafter referred to as (FINSAP) to address the emerging problems of the financial sector. The main objectives of FINSAP were: (1) to deregulate interest rates and remove ceilings on deposit and lending rates; (2) to privatize government-owned financial institutions and commercial banks; (3) to enhance the soundness of the banking institutions by improving prudential regulation and supervision by the BOG; (4) to improve deposit mobilization and increase efficiency in credit allocation; and (5) to develop the money and securities markets.

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[6] Insolvency means a situation where a financial institution's liabilities exceed its total assets. An auditor's report shows that in 1987 the majority of the government-owned commercial banks were in technical default as their liabilities exceeded their assets.

2.2. Research Questions

Critics of the FINSAP argue that the liberalization measures instituted in 1988 as part of the financial sector reform were not far reaching enough to solve the root causes of the Ghanaian financial sector problems. They argue that the reforms were not geared towards full liberalization of interest rates and other policy and institutional rigidities that militate against the well-functioning of the financial market. Thus, the relevant questions that were raised about the banking sector reform include: (1) What are the remaining reform issues and constraints to banking efficiency and savings mobilization in Ghana? (2) How did commercial banks react to the financial sector reform? (3) What regulatory changes were instituted and how did the policy reform affect banking efficiency and savings mobilization? (4) How did the public, especially depositors react to the policy changes after the financial sector reform?

2.3. The relevance of the study for growth with poverty alleviation (equity)

This study is relevant for growth with equity for several reasons. First, structural adjustment was undertaken in Ghana in the early 1980s as a response to the poor economic conditions and to alleviate mass poverty and hunger in Ghana. However, despite the initial gains in its economic recovery, the poverty level remains very high. A recent survey by the World Bank (1995) shows that one out of every three Ghanaians is below the poverty line. The study concludes that the only way out of Ghana's poverty quagmire is to adopt policies that promote economic growth and poverty alleviation because no country has ever achieved poverty reduction without a sustained economic growth. However, one of the constraints to growth in Ghana is the inability of the banking system to mobilize a greater financial savings for allocation to the productive sectors of the economy.

This study is timely because the analysis of the above research questions and policy issues will lead to the development of alternative policy recommendations that will enhance savings mobilization and credit allocation to the private sector for economic growth with equity.

Also, since most residents are small savers, having an efficient banking system provides them with market rate of return on their savings. This is because an inefficient banking system with negative real interest rates tends to punish small savers who do not have any access to international markets for hedging their financial assets. In addition, since high interest rate spreads between lending and deposit rates punish savers by offering them below market deposit rates, policies that result in reducing high interest rate spreads and raising deposit rates would prove beneficial to small savers who constitute the greater majority of the depositors.

III. Financial Sector Reform Program 1988

By the late 1980s, the World Bank and the Ghana Government had agreed that a reform and restructuring of the financial system was indispensable to a successful economic recovery program. With technical and financial assistance from the IDA through a Financial Sector Credit (FINSAC 1), the government embarked upon a Financial Sector Reform Program (FINSAP) in 1988. The objectives of the program were:

1. To undertake restructuring of financially distressed banks;
2. To improve savings mobilization and enhance the efficiency of credit allocation;
3. To enhance the soundness of the banking system through an improved regulatory and supervisory framework;
4. To develop money and capital markets;
5. To establish a non-performing assets recovery trust

The IDA-supported study identified seven banks as "distressed". The restructuring of these banks involved the following measures: (a) reconstitution and strengthening of Board of Directors of affected Banks; (b) closure of unprofitable branches; © reduction of operating costs through retrenchment of staff; (d) cleaning of balance sheets by off-loading non-performing loans to state-owned enterprises, loans guaranteed by the government of Ghana, and non-performing loans granted to the private sector. Other changes include upgrading of managerial capacity and deficiency of distressed banks, intensified staff training of affected banks, and the provision of enough capital and adequate liquidity to enable the distressed banks to operate in a self-sustaining manner after restructuring.

Part of the process of restructuring banks involved removing from the banks portfolios all nonperforming loans and other Government-guaranteed obligations to state-owned enterprises which totaled ¢31.4 billion at the end of 1989 and nonperforming loans to the private sector amounting to ¢21.9 billion at the end of 1989 through the issuance of bonds. The nonperforming assets of the distressed banks were transferred to a newly created and wholly-owned government agency – the Non-Performing Assets Recovery Trust (NPART) whose mandate was to realize such assets to the extent possible. In return, the distressed banks were issued interest-bearing FINSAP bonds which were to be redeemed in annual installments. A sunset provision in the 1989 Law which set up NPART limited the life of NPART to a six-year time frame. The above reforms known as FINSAP 1 were carried out between 1988 - 1990. In 1990, FINSAP 2 was launched with the following objectives:

(1) To continue and complete any unfinished business under FINSAP 1;
(2) To reduce state share holding in Ghanaian banks
(3) To divest state owned banks in accordance with financial liberalization and deregulation;
(4) To intensify the recovery of non-performing loans by NPART
(5) To reform the institutional structure of the bank of Ghana; and
(6) To enhance the effectiveness of the non-bank financial institutions.

3.2. The Banking Law of 1989

The Banking Act of 1970 did not provide sufficiently clear guidelines to the banks and the banking authorities on minimum capital requirements, risk exposure, and prudential lending limits for banks, provisions for possible loan losses and methods for interest accrual on non-performing loans. Thus, the singular importance in the reform measures is the new Banking Law of 1989. The law explicitly defines the minimum capital requirements for various types of banks and by bank ownership. (1) The minimum paid-up capital for commercial

banks with at least 60% Ghanaian ownership was fixed at 200 million cedis. (2) For foreign banks with Ghanaian ownership less than 60%, the minimum paid-up capital required is 500 million cedis. (3) Development banks are required to maintain a minimum paid-up capital of one billion cedis. (4) Each bank is required to maintain a minimum capital adequacy ratio of 6 percent although the Bank of Ghana has the discretion to increase it.

The 1989 Banking Law also dictates explicit safeguards as well as penalties for excessive risk taking. These include: (a). Maintenance of a reserve fund from annual profits. Funding depends on the ratio of reserve fund balances to paid-up capital, and this can be as high as 12.5% of net profits. (b). Banks cannot lend more than 25% of their networth by way of secured loans and not more than 10% of networth by way of unsecured credit.
c). Banks may not undertake non-bank activities directly. They can do so only through subsidiaries. In any case, the Law regulates equity and loan exposure of a bank in such subsidiaries, thereby preventing insider lending. (d). Bank of Ghana's examination and supervisory functions have been upgraded and a comprehensive system of reporting was introduced to enable Bank of Ghana carry out systematic on-site and off-site analysis of any bank's performance and financial condition. If necessary, Bank of Ghana can issue cease-and-desist orders, and even take control of banks that are financially weak or have fallen short of the provisions of the Banking Law. (e). Penalties in respect of non-compliance with provisions of the 1989 Banking Law have been increased to make them effective.

Another important reform measure introduced was the enactment of the Non-Bank Financial Law of 1993 with the following main features.
a). Coverage of the NBFI Law is in respect of discount houses, finance companies, acceptance houses, building societies, leasing and hire-purchase companies, venture capital funding companies, mortgage financing companies, savings and loans associations, and credit unions.
b). The minimum capital requirement for the establishment of an NBFI was set at 100 million cedis.
c). The minimum capital adequacy ratio is set at 10% of risk assets and Bank of Ghana has the authority to prescribe the minimum level of liquid assets. Exposure limits are put at 15% of net worth for secured advances and 10% of unsecured advances.
d). Unlike pre-reform era where money lenders had to be licensed by the police and other nonbank institutions had to obtain their licenses from the Registrar General's Department, Bank of Ghana is now the designated authority to license and regulate NBFIs.
e). NBFIs can accept deposits from the public, but only for a fixed period of not less than three months unless with prior exemption from Bank of Ghana.

The liberalization of the banking sector and the subsequent enactment of the new Banking Law and NBFI Law appeared to have streamlined the emergence of financial institutions to add some depth and diversity to the financial system. In this regard, various types of NBFIs have been established by private entrepreneurs, targeting, as it were, categories

of savers and investors largely not accommodated by the banking system with such services as equity finance, long-term credit for industry and real estate, and small-scale savings.

By and large, the establishment of these non-bank financial institutions means that financial services can be extended beyond the range typically provided by the banks. This is one way of increasing competition and enhancing the efficiency in financial intermediation.

In the case of bank development, the period of reforms since 1990 witnessed the establishment of 7 new banks.

IV. Research program and methodology

This study involves field work and administration of survey questionnaires to a sample of target groups comprising: (1) bank managers, (b) bank staff and employees, © regulators, and (d) bank depositors. In view of budget constraints, we surveyed 36 bank branches in four regions of Ghana. Survey questionnaires have also been administered to a selected sample of rural banks and examiners at the head office of Bank Supervision Department. In addition, we also interviewed bank managers about their assessment of the impact of the FINSAP on bank operations and their own reaction to the reform measures enacted since 1988.

Sample selection of bank depositors was based on a random selection of bank depositors at the bank premises during the normal business hours of the bank. The survey was conducted by four field research officers under the supervision of the principal and co-principal investigators in Ghana. The sampling of bank employees and staff was done at the discretion of the branch managers. However, in order to maintain confidentiality of the responses, we provided envelopes for each employee to enclose the responses after its completion. However, prior to the distribution of the questionnaires, the principal investigator and the co-investigator went to see each Managing Director to explain the process and ask permission for the interview. Many managers expressed interest and their co-operation with researchers. However, two bank managers requested that they should be briefed about the result of the study prior to its wider dissemination.

In addition to the primary data, we also collected secondary data from the individual banks and the Bank of Ghana. The secondary and time series data is based on (1) the consolidated balance sheet and income statement of commercial banks in Ghana; (2) prudential and audited returns which commercial banks file periodically (weekly, monthly, quarterly, half yearly, and yearly) with the BOG; (3) macro-financial data from Bank of Ghana; (4) macroeconomic data from the Ministry of Finance and other National Account statistics.

At the time of presenting this progress report, we have not collected all data required for this study. In addition, we have not completed a full analysis of the survey results. Consequently, our findings may be regarded to be tentative.

V. Preliminary Findings

5.1. Introduction

The liberalization of the banking sector and the subsequent enactment of the new Banking Law appeared to have streamlined the emergence of financial institutions to add some depth and diversity to the financial system. However, at the time of this report, we have not completed the analysis of the field survey questionnaires and the secondary data we collected from the bank of Ghana. Thus, the following findings may be considered as preliminary findings. The following section covers a discussion of the characteristics of the new and emerging private banks in the post-reform era.

5.2. Characteristics of the new private banks

It is important to emphasize that until the 1990, no private banks were licensed. In terms of management and other staff of the new banks, available evidence shows that many of the top management team have held top posts in some of the older banks, including two former Governors of the Bank of Ghana. Typically also, most of the staff of the new banks are experienced bank officials who have been enticed to join the new banks from the older banks. With the divestiture of about 40% Government shares in Social Security Bank and Ghana Commercial Banks in the 1990s, there has been more private involvement in the banking industry in Ghana than was the case before reforms.

An analysis of the financial services provided by the new banks show that despite the fact that they have been licensed as merchant banks, in practice, they perform commercial as well as development and merchant banking. These new banks are one-stop-shop banks or financial supermarkets offering virtually all types of financial services under one roof. These services are characterized by a combination of deposit taking and credit allocation to the private sector. Unlike the older banks, the newer banks operate subsidiaries for providing diversified services to their clients.

Ecobank Ghana Ltd has as subsidiaries ECOBANK Stockbrokers Ltd (ESL) and EBG-Investment Managers Limited (EBG-IML) to perform specialized services. ESL is one of the 3 pioneer licensed dealing members of the Ghana Stock Exchange. Its services include portfolio management; equity research; initial public offering; debt/equity swap; retail and institutional brokerage services to both domestic and international clients.

Trust Bank describes itself as a "universal bank" that provides a variety of services including (a) corporate financial advisory services; (b) provision of trade finance facilities such as preshipment advances, loans against trust receipt; accessing funds in the international market for short, medium and long term foreign loans. Other services include development promotion of exports, appraisal and financing of projects and other related financial services.

Theoretically, the new breed of banks have certain inherent advantages in so far as

Bank of Ghana has accepted them as a nucleus of universal banks. The formation of the new banks represents an important milestone after the financial sector reform. The following table represents a comparative analysis of selected financial indicators of the new and the old banks in Ghana.

Table 1: Financial Indicators Of New And Old Banks-1995

Bank	Nominal Interest Rate Spread %	Loan As% Of Total Assets	"Riskless" Investment As % Of Total Assets	Current Account Deposit As % Of Liabilities	Time Deposits As % Of Liabilities	Provision For Bad Debt %
BBG	6.9	17	26	65	4	1
SCB	21.5	27	26	25	2	1
GCB	8.4	7	60	44	9	4
SSB	1.3	15	41	46	10	4
Average	9.4	16.5	38.3	45	6.3	2.5
EBG	14.2	14	66	53	23	2
Cal Merchant	16.5	24	16	37	40	4
Trust	23.3	10	36	49	34	6
Metro.	15.0	-	54	15	70	-
Average	17.3	16	43	38.5	41.8	4
BHC	10.3	24	20	33	13	15
ADB	13.4	38	30	35	10	4
NIB	10.9	34	33	58	12	5
Average	11.5	22	28.7	38.3	11.7	8

Source: Bank Of Ghana Records.

The above table shows that the new banks[7] established after the promulgation of the 1989 Banking Law on average tend to have larger nominal interest rate spread than the established commercial banks and development banks. This does not support the earlier findings of the World Bank (1994) that the new banks have lower interest margins than the older banks. Apart from

[7]Some of the new banks for which data was available include CAL Merchant Bank, Trust Bank, and Metropolitan Allied Bank.

Standard Chartered Bank whose spread was about 22%, none of the older commercial banks had a spread as high as the lowest spread of the new banks. However, our findings support the earlier findings that on the average, the new banks appear to have mobilized more long-term funds from the public than the older established banks. However, this increased mobilization of long-term funds did not translate into increased credit to the private sector. Instead, the newer banks have increased the investment in relatively safe short-term government Treasury bills than the rest of the older banks. The above table shows that the share of credit to the private sector by the new banks was the least as compared with the other two groups of older banks. On the other hand the newer banks contributed the largest share of their funds to investment in government securities.

5.3. Innovative Financial Practices

A major feature of the pre-FINSAP characteristic of the Ghanaian financial sector was the lack of innovation and preponderance of a payment system dependent on cash basis. However an emerging feature of the post-FINSAP development in the financial sector is the introduction of innovative and competitive elements in the banking system. This competition is being driven by information technology and process of delivering banking services.

This competitive element has led to re-packaging of banking services and the introduction of high technology-backed customer services. In terms of product specifics, time and savings products have been made more competitive in terms of product differentiation by the players in the banking sector. For example, Standard Chartered, Barclays, and Trust bank have introduced savings accounts that attract multi-tiered interest rates and linked to free personal accident insurance. Standard Bank's saving and insurance package entitles savers to a lump sum benefit which is twice the current balance in the account not exceeding ¢1m. Similarly, Trust Bank offers a "gold account" that is a hybrid of normal current and savings accounts. The "gold account" offers the depositors an opportunity to issue checks drawn on the account while the account continues to earn a higher premium. In addition, interest is compounded daily on the account unlike other savings accounts that attract interest compounding on a quarterly or yearly basis. In addition, there are no bank charges on the "gold account."

In most cases, however, these new saving products do not attract positive real rates of interest because of the exceptionally high rates of inflation in Ghana. Moreover, Government papers also attract higher rates of interest, and are indeed profitable investment avenues for banks.

The other innovations that have emerged after 1988 may be termed process innovation which refers to the way banks deliver bank services and products to the public. This innovation has been made possible by the introduction of microelectronic technology that has the potential in broadening the payment system which was predominantly cash based. The introduction of computers at bank branches and installation of automatic teller machines (ATM) seemed to set in motion a revolution in the banking system in Ghana.

The frontline fight for market shares using automation was pioneered by the Trust Bank which has installed automatic teller machines (ATMs) that allow customers 24 hours of access to their funds. Trust Bank has linked all its branches to an automated clearing house so that a customer can withdraw funds at any of the branches.

Following closely are the big foreign-owned banks, Standard Chartered Bank and Barclays Bank. These banks have centralized operations at their respective head offices with networking to all their branches to enable customers to check their balance, make withdrawals or deposit funds to their accounts.

Ecobank (ECONET), Standard Chartered Bank, and Barclays Bank have created opportunities, especially for their corporate customers to initiate a range of automated transactions from their own offices or homes. Using a personal computer, telephone, modem and bank-installed software, a customer is able to access his/her account, get information about exchange rates as well as interest rate.

In terms of international fund transfers, Agricultural Development Bank has linked up with Western Union Money Transfer to allow its customers to receive funds from the rest of the world at any of the Bank's branches. Social Security Bank has similarly introduced an electronic funds transfer scheme, the MONEY-GRAM receivable at any SSB branches.

The application of microelectronics has a potential of increasing efficiency of banking activities in Ghana. Automation tends to reduce operating costs associated with manual operations, especially delays and manpower costs. Invariably, the main costs involved in banking derive from the need to store large amounts of information, the need to access the stored information quickly, and to update such information continually. The introduction of microelectronics in banking has reduced these costs considerably through both scale and scope economies. As it is expected, those banks in the vanguard of information technology are also the leading profit earners. Standard Chartered Bank that invested heavily in the information technology recorded a pre-tax profit of ¢42.7 billion in 1996. This represented a 74% increase over the profit earned in 1995. Similarly, Barclays Bank's pre-tax profit increased by 40% from ¢15.8 billion in 1995 to ¢22.13 billion in 1996. Ecobank's pre-tax profit increased by 64% in 1995 to ¢13.1 billion in 1996 while Agricultural Development Bank recorded an increase of 24% over the 1995 figure settling at ¢19.3 billion.

The emerging pattern of financial innovation seemed to suggest that Ghana's evolution of payments system appears not to be paralleling payment system developments in other countries. However, it appears as if the ongoing financial innovation is preparing Ghana to by-pass the predominantly cheque-use stage.

The current innovation in Ghana marks a major departure from the predominantly cash-based payments system in Ghana. Currency is the predominant means of payment, embracing over 95% of transactions that involve transfer of value between economic agents. Cheque transactions account for about 2% of non-cash transactions. Results from our survey indicate that the low level of cheque usage is due to a general lack of confidence in checks as a payment media. Out of 15 large companies and Government departments including the Internal Revenue Service,

Customs, Excise and Preventive Service that were interviewed, all indicated that they would not accept business cheques as payments. The two basic reasons given for the non-acceptability of cheques are delays in clearing cheques and the likelihood that the checks will be dishonored. As a remedy to the latter, all respondents noted that they would rather request bank draft which was as good as cash.

Interviews with bank managers show that apart from special clearing which is done expeditiously depending on the traffic situation in Accra, and at cost to the payee, intra-Accra cheque transactions take 3 days. On the other hand, cheques drawn on banks outside Accra take from a week to four weeks.

Although over 75% of business executives interviewed indicated that they would welcome the introduction of cheque guarantee cards such as Standard Bank's "service card" and Barclays Bank's "Barclay card," it was observed that these executives would still be hesitant if the clearing system is not improved. In a similar survey, respondents welcomed the guarantee cards but they nevertheless prefer the electronic means of payment such as SSB's "Sika card," Trust Bank's "auto cash card," SCB's "money link card," and Barclays Bank's "Barclay Cash Card." Although these cards are yet to be processed into an automated clearing house, they offer the opportunity to electronically make a deposit or make a withdrawal from a bank account. The emerging payment system with the electronic cards suggests that Ghana is poised to by-pass the cheque stage. This innovative process in Ghana has the potential of increasing financial deepening and increased mobilization of savings for investment and growth. In the following section, we examine the extent to which the innovating changes have contributed to financial deepening and savings mobilization.

5.4. Financial deepening and saving trends

The academic literature postulates that financial sector reform accompanied by an increase in real interest rates has a tendency of encouraging economic units to hold more financial assets. It is also postulated that a greater volume of financial assets in the hands of the public is associated with high levels of savings, investment and growth. However, the results of our study would show that increases in financial deepening does not necessarily lead to increased savings and allocation of credit to the private sector.

In addition, we wish to point out that the traditional measure of financial deepening which includes (M1 + time deposits) underestimates the public's holding of financial assets. It has been recognized that in addition to the traditional M2 definition, the growth in government securities in the hands of the public has been overlooked in the academic literature (World Bank, 1996.) The popularity of government securities, especially government Treasury bills has made it necessary to redefine the concept of financial deepening. In addition, the ability of Ghanaian citizens to maintain savings deposits in foreign denominated currencies has made it imperative to

broaden our definition of financial deepening to include M2 plus government short-term Treasury bills in the hands of the non-banking public and deposits held in foreign denominated bank accounts.

The recent policy change by the Bank of Ghana to include foreign deposits in the monetary aggregates marked a major departure from the traditional monetary control target. As a result banks are required to hold cedi denominated reserves to support any accounts held in foreign denominated bank deposits. However, others argue that such effort on the part of the government has led to widespread use of foreign currencies as a medium of exchange in the domestic economy. Another unintended negative consequence of the above policy change was the substitution of foreign currencies for domestic currencies as a hedge against inflationary pressures. This has popularly become known as "Dollarization" which has caught the attention of the policy makers in Ghana.

Data on foreign deposit accounts by Ghanaian residents showed that foreign denominated deposits has become the fastest growing financial assets in Ghana. The data showed that on average, between 1991 and 1996, foreign denominated deposits grew by about 99 percent annually. This marks a major departure from the pre-FINSAP period where individuals hedge against future inflationary pressures by holding physical goods rather than financial assets.

5.5. Savings Mobilization

It may be argued that the emergence of the new banks has increased the potential for greater mobilization and allocation of credit to the private sector. However, the anticipated increases in savings mobilization had not materialized a decade after the financial sector reform.

The question that the current saving trends raises is why has Ghana's experience with financial reform not yet yielded the anticipated results in the form of increased domestic financial resource mobilization? This is investigated at both the micro and macro levels. At the micro level, we interviewed bank customers about their perceptions of those variables that determine savings behavior. These include availability of banks or deposit taking institutions, structure of interest rates, income levels, and quality of bank services. We also examined the issue of the confidence factor relating to macroeconomic stability and the governments unorthodox policies of the late 70s and early 80s.

In terms of the micro level determinants, we surveyed depositors at various bank branches in Accra, Kumasi, Sekondi/Takoradi and other rural banks to find out their saving behavior. On the question of interest rate sensitivity, about 60% of 1526 respondents indicated that if interest rates were to increase appreciably, they will reorganize their wealth portfolio by reducing consumption expenditure and increase savings.

Table 2: Selected Indicators of Savings Mobilization

Year	M2/GDP	M1/GDP	QM/GDP
1989	0.17	0.13	0.04
1990	0.14	0.11	0.03
1991	0.13	0.09	0.04
1992	0.17	0.12	0.05
1993	0.17	0.12	0.05
1994	0.20	0.14	0.06
1995	0.18	0.12	0.05
1996	0.19	0.13	0.06

Source: Computed From Bank of Ghana Figures

This finding supports the large following that the "magic banks" received up to the middle of the 1990s. The magic banks are new breed of financial institutions that offer deposit rates between 30 and 50 percent per month to depositors. Unlike earlier findings which showed that saving with informal financial institutions was primarily to afford depositors the opportunity to have access to credit and the friendliness of the organizers, over 90% of 1251 respondents that saved with the "magic banks" indicated that they did so purely for the interest income. While the response to the instruments offered by the magic banks showed that the public can respond to high interest rates, the activities of the banks nevertheless tended to undermine the very core of the financial system as a whole. First, available evidence showed that many businessmen abandoned their main line of businesses and deposited their funds with the "magic banks" to earn at least 30% interest per month - a rate of return that would not normally be achieved in the normal line of business.

Secondly, some depositors moved their savings from the formal banking system into the

Magic Banks[8]. The researchers noted that even high ranking army officers who earned foreign exchange from peace missions abroad deposited with the "magic banks." Also traders on the Ghana Stock Exchange complained that the activities of the "magic banks" were affecting patronage in the stock market as most of their notable dealers went to the magic banks. Also, discussions with Bank of Ghana officials revealed instances where people borrowed money from the formal banking system at about 39% per annum and deposited such funds with the "magic banks" for at least 360% rate of interest.

While the interest rates paid by the "magic banks" to depositors can be described as too high and therefore unsustainable, the activities of these " magic banks" nevertheless tend to suggest that given the right interest rate regime, the public will increase their savings rate.

As regards the proximity of deposit institutions and their impact on savings mobilization, over 80% of the respondents indicated that their choice of bank was largely influenced by nearness to work place or to the place of residence. Another 15% indicated that the over-riding factor was the quality of service, possibly as a result of having access to bank officials who can help in quick delivery of financial services.

Despite the prevailing negative real rate of interest, 40% of depositors interviewed indicated that they would save more at the prevailing rates of interest if their income increases substantially. The general picture that has emerged is that those with higher incomes tend to save more. However, those with higher incomes but with extended family obligations tend to save less. This was particularly observed when the researchers interviewed university workers and lecturers.

Our survey results showed the general concern of the lack of confidence in the financial sector. This confidence factor can be traced to macroeconomic instability and the lingering effects of the unorthodox policy measures of the late 1970s and early 1980s. Macroeconomic instability of high inflation and the generally persistent depreciation of the cedi against the major world currencies had a negative impact on savings mobilization. Although inflation has been brought down from the record high of 123% in 1983 to as low as 10% in 1991, it went up since the inception of the ERP.

As a result of the rising inflation and the successive decline in the value of the cedi, nominal interest rates would have to rise significantly to yield a positive real rate of interest. However, the trend in interest rates shows that while nominal rates were generally high since the late 1980s, the intractable inflationary pressures meant that real deposit rates were largely negative. Table below shows the interest rate structure. Comparative analysis of the deposit and Treasury bill rates showed that with the exception of 1992 and 1995, the real rates on Treasury bills were positive. This resulted in financial disintermediation from the banking sector. This evidence would show that there has been a shift in the public's portfolio adjustment in favor of increased

[8] These Magic Banks include PYRAM and Resource 5. Their operations are now under review by Bank of Ghana.

holding of government Treasury bills instead of savings with the banking system.

Table 3: Interest Rate Structure

YEAR	Nominal Saving Rate	Nominal Lending Rate	Nominal Treasury Bill Rate	Rate Of Inflation	Real Saving Rate	Real Lending Rate	Real Treasury Bill Rate
1990	0.180	0.3025	0.218	0.372	-0.140	-0.051	-0.112
1991	0.200	0.315	0.292	0.180	0.013	0.114	0.095
1992	0.160	0.290	0.194	0.100	0.055	0.173	0.085
1993	0.230	0.390	0.310	0.250	-0.020	0.112	0.048
1994	0.230	0.380	0.273	0.249	-0.015	0.105	0.020
1995	0.251	0.418	0.358	0.708	-0.268	-0.170	-0.205
1996	0.315	0.477	0.417	0.327	-0.009	-0.216	0.068

5.6 Currency Substitution Or Dollarization

Another facet of the macroeconomic instability is manifested in the increasing trend of currency substitution as a means of financial saving. As a result of the financial sector reform, Ghanaians are permitted to operate a Foreign Currency Account and Foreign Exchange Account. The former is an account to hold remittances from other countries while the latter is an account into which foreign currencies can be deposited by individual depositors in Ghana. However, in order to prevent capital flight, foreign transfers are not authorized from the Foreign Exchange Accounts. Between 1990 and 1996, foreign denominated deposits had increased by 99 percent on annual basis. This shows that the Foreign Exchange Accounts have become the fastest growing financial assets in Ghana.

An unintended consequence of this new development is the holding of foreign denominated accounts by Ghanaians. Ordinarily, the substitution of dollars for cedis can be viewed as a natural consequence of portfolio diversification in a world of high capital mobility. But when foreign currencies replace the domestic currency as the store of value and in most cases as a unit of account or a medium of exchange, then raises serious issues for the effectiveness of monetary policy.

Currency substitution in Ghana has been exacerbated by the fact that most trading firms including transnational companies have been quoting prices of their wares in dollars as a means of hedging against inflationary pressures and perennial devaluation of the Ghana currency. In order to prevent the negative consequences of the above development, Bank of Ghana has taken action to include foreign denominated deposits in the monetary aggregate popularly known as M2. In addition, commercial banks are required to maintain a reserve balance of 8 percent of all deposits

denominated in foreign currencies. Results of our interview with some of the bank managers in Ghana revealed that the new measure has put more pressure on the banks to cover all deposits in foreign accounts with cedi reserve balances. This, according to the bank managers may have negative consequences of driving depositors of foreign currencies to offshore bank accounts.

This raises a policy dilemma for the monetary authorities. Ghana's experience has so far suggested that a stable macroeconomic environment is necessary for the enhancement of financial deepening and savings mobilization. Government can create such an environment through fiscal discipline and institution building.

Table 4: Changes in Foreign Demand Deposit and Broad Money (M2)
(In Percentages)

Quarter	Growth In Foreign Deposit	Change In M2	Foreign Deposit As a % of M2
(1)	(2)	(3)	(4)
June 94	20.12	8.97	28.45
Sept 94	114.54	6.50	39.13
Dec 94	22.00	23.18	38.13
March 95	8.61	1.24	1.60
June 95	17.39	7.13	45.59
Sept 95	-41.97	3.27	25.62
Dec 95	11.90	22.71	23.36
March 96	19.98	3 .95	26.96
June 96	6.23	7.80	26.57
Sept 96	13.36	7.60	27.99
Dec. 96	10.14	11.33	27.69
Average	18.23%	9.47%	31.14

Source: Computed from Bank of Ghana Quarterly Bulletin, Various Issues

5.7. Interest rate spreads as a measure of bank efficiency

An efficient banking system also relates to the interest rate spread between deposit and lending rates. An efficient banking system with vigorous competition will lead to narrow interest rate spreads and a socially optimum allocation of society's scarce resources. Below is the record of interest rate spread of the Ghanaian banking system from 1990 to 1996.

Table 5: Interest Rate Spread

YEAR	Nominal Saving Rate	Nominal Lending Rate	Interest Rate Spread
1990	0.18	0.3025	0.122
1991	0.20	0.315	0.125
1992	0.16	0.290	0.134
1993	0.23	0.397	0.165
1994	0.23	0.38	0.156
1995	0.251	0.418	0.167
1996	0.315	0.477	0.162

Source: Calculated from Bank Of Ghana, Quarter Bulletin, various issues

The large spread between lending and deposit rates offers unattractive reward to savers. Moreover, the interest rate structure suggests that the banks are not particularly interested in aggressive saving mobilization. Furthermore, the high interest rate spreads leads to high cost to borrowers. In addition, this tend to discourage private investment. At a time when the government Treasury bill rate was 45% per annum and reserve requirements stood at 57 percent of deposits, the banks could mobilize savings at a cost of about 20% and invest it in riskless Treasury bill and reap a premium of over 20 percent.

However, our analysis of he micro-level data on interest rates shows that the aggregate data on interest rate has a tendency of concealing the micro-level differences in interest rate spreads of individual banks[9]. For example, in 1995, average deposit rate for the banking industry was

[9] Banks consider the following factors to determine lending rates: the banks prevailing cost of funds; the Bank of Ghana rediscount rate; rates prevailing for Government/Bank of Ghana gilt-edged instruments available; and rates quoted by competitors in the industry. The cost of funds are in turn calculated as the weighted average of deposits, the weighted

27.4%. Barclays Bank had the highest deposit rate 32.6% while Standard Chartered Bank had the lowest rate of 20.2%. In the case of lending rates, industry figure averaged 41.4%. Bank for Commerce and Credit's lending rate of 50% per annum was the highest whilst Social Security Bank's lending rate of 32.4% was the lowest. Table 6 shows the nominal interest spread for the individual banks for 1995.

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average of share-holders funds. the weighted average of residual overheads, and the weighted average of loan loss.

Table 6: Nominal Interest Rate Spread For Banks- 1995

Bank	Average Lending Rate	Average Deposit Rate	Nominal Spread
Barclays Bank	39.5	32.6	6.9
Standard Chartered Bank	41.7	20.2	21.5
Ghana Commercial Bank	38.1	29.7	8.4
Social Security Bank	32.4	31.1	1.3
Bank for Housing And Construction	37.8	27.5	10.3
Agricultural Dev. Bank	41.5	28.1	13.4
National Investment Bank	40.0	29.1	10.9
Merchant Bank	38.5	27.5	11.0
Bank for Commerce	50.0	20.5	29.5
Eco-Bank	41.5	27.3	14.2
Cal Merchant Bank	42.0	25.5	16.5
Cooperative Bank	45.3	28.9	16.4
Trust Bank	44.3	21.0	23.3
First Atlantic Merchant Bank	44.5	34.9	9.6
Metropolitan and Allied Bank	44.5	29.3	15.2
Banking Industry	41.4	27.4	14.0

Source: Bank of Ghana records

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From the table, the average lending rate for the banking industry in 1995 was 41.4% whilst the average deposit rate was 27.4%, giving 14% spread. Bank for Commerce and Credit had the highest spread of 29.5% whilst Social security bank had the lowest spread of 1.3%. Invariably, where large spreads exist, the main underlying factor appears to be due to the nonpayment of interest and/or low interest on substantial amounts held as demand deposits.

VI. Allocative Efficiency of Credit during FINSAP

6.1. Introduction

Researchers define allocative efficiency in terms of the availability and allocation of credit to the productive sectors of the economy for growth. The view is that allocative efficiency of commercial banks should relate to socially optimum allocation of scarce financial resources for growth. This implies that financial resources should be allocated to the most productive investment projects. There is the assumption that credit increases arising from improved savings to finance private sector business activities will enhance growth and poverty alleviation.

Table 5 shows total domestic credit to the government, public institutions, and the private sector. The first general picture is the drastic fall in total credit/GDP ratio from about 28% in 1987 to about 8% in 1988, and the subsequent consistent decline to 1.13% in 1991. It rose dramatically to about 15 percent in 1992, and the fell to 6.45% in 1993. It never recovered appreciably to any where near the pre-FINSAP ratios. The 1992 outlier could be explained in terms of government's liberal approach to extend credit to all sectors of the economy during an election year.

With regard to the distribution of domestic credit between public sector in general and private sector at large, the 1982-1987 period tends to suggest that the former was the main beneficiary of domestic credit. Since FINSAP in 1988, credit to the private sector appears to be greater than that to the public sector as a whole. However, this may be misleading as the government now relies heavily on borrowing from the financial markets than through the banking sector. Thus the proper way of comparing the allocation of credit to the government sector is to combine bank credit with securities issued by the government.

Also, in an attempt to restrain monetary growth, the Bank of Ghana imposed high reserve requirements on banks' total deposits. The banks were encouraged to invest in government bonds and securities so that government is the largest beneficiary of the securities market. The asset structure of banks indicates massive investments in Treasury bills and bonds. This is facilitated by government borrowing and offers of relatively risk-free instruments.

Furthermore, Government has been engaged in proxy borrowing. All this has a tendency to weaken the argument that public sector borrowing has not crowded out the private sector. Prima facie, liberalization notwithstanding, credit allocation is still inefficient.

Table 7: Total Domestic Credit: Percentage of Total

Year	Credit To Govt Insts.	Credit To Public Sector	Credit To Private	Total Credit	Total Credit GDP/Ratio
1982	59.13	32.53	8.33	100	21.69
1983	52.46	45.38	2.16	100	33.89
1984	78.49	8.98	12.53	100	17.88
1985	64.04	21.75	14.21	100	22.25
1986	66.38	17.24	16.38	100	23.26
1987	78.11	9.95	11.94	100	27.71
1988	13.83	13.09	73.08	100	7.77
1989	-14.86	27.96	86.90	100	4.97
1990	-78.97	32.02	146.95	100	2.12
1991	-253.59	68.09	285.50	100	1.13
1992	6.39	71.01	22.59	100	14.91
1993	2.58	23.52	73.91	100	6.45
1994	-9.30	41.97	67.33	100	8.20
1995	-21.39	40.95	80.44	100	6.59
1996	12.26	19.00	68.73	100	10.81

Source: Calculated from Bank Of Ghana data, Quarterly Economic Bulletin, Various Issues.

6.2. Credit Allocation Index

In order to examine the linkage between the efficiency of credit allocation and growth, we analyzed the pattern of growth during the post-reform period. If growth occurred, we examine the share of different sectors in total GDP. Next, we look at the sources of growth as a second order efficiency condition. Indications are that the services sector is the largest single sector, and indeed, the source of economic growth since the financial reforms. It is our basic hypothesis that the growth-leading role of the services sector has been facilitated by the flow of credit to the sector. That is, any shifts in the pattern of credit allocation among sectors would partly be due to changes in the relative

TABLE 8
GDP GROWTH RATES AT CONSTANT 1990 PRICES

	GDP -Million Cedis	Percentage Change
1981	1594	-1.79
1982	1479	-7.21
1883	1490	0.74
1984	1529	2.62
1985	1607	5.10
1986	1690	5.16
1987	1772	4.85
1988	1871	5.59
1989	1966	5.08
1990	2032	3.36
1991	2140	5.31
1992	2223	3.88
1993	2333	4.95
1994	2418	3.64
1995	2526	4.47
1996	2656	5.19

Source: Statistical Service

The table 6 shows that the negative trend in real GDP growth rates has been reversed since the inception of the economic reforms (ERP). Consequently, on the basis of the "before and after" evaluation methodology, we shall have to conclude that the liberalization policies were effective in halting the negative GDP growth rate. However, the general concern by policy makers is the sustainability and increased growth rate in the face of declining savings rate.

An examination of the respective sectors' relative shares in economic activity indicated other implications for policy analysis. Besides the early years of ERP between 1984-1986 when agricultural sectors share rose from about 55 percent to about 60% in GDP, the sector's share in subsequent years has steadily declined to about 40.8% in 1996. Considering the fact that the agricultural sector used to contribute the largest share in terms of production and labor force, its decline has policy implications for food prices, employment, and increase in poverty level.

The industry sector, especially growth in manufacturing has also remained very weak during the post-reform period. The share of the industry sector in GDP declined from 14.4% to 14. 1%. However, the only bright spots are the construction and the service sectors. The service sector's share in GDP increased from 41.0% in 1988 to 48.3 % in 1996 while the construction sector's share increased from 2.6% in 1988 to 3.0 percent in 1996. Thus, the service sector has become the largest contributor to GDP growth during the post-adjustment period.

As a measure of second order efficiency, we look at the sectoral allocation of bank credit by

broad categories of economic sectors. This is to examine the impact of the redirection of credit to the various sectors after the post-reform period.

On the other hand, the share of the Services's sector rose steadily since 1984 from about 37% to over 48% in 1996. In the case of Industry, the change is not significant. Apart from a modest gain from 11.6% in 1984 to 13.3% in 1986, the sector's share hovered around 14% between 1987 and 1996. However, besides the modest increasing trend in the manufacturing sub-sector of Industry sector from 1984 to 1987, its share in GDP has declined from 9.4% in 1987 to 8.1% in 1996.

Thus, any structural transformation that occurred in GDP was between Agriculture and the Services sector. Data indicated a 3 percent GDP rate for 1990 whilst the percentage change in the agricultural sector's share in GDP for the same year declined by 2.4 percent. In the light of the declining trends in the agricultural and manufacturing activities, any growth that occurs in the GDP must therefore originate in the construction activities and services sector. The services sector grows at an increasing rate to offset the poor performance of the other sectors.

It is in this context that we define efficient credit allocation in terms of production efficiency and stipulate as a necessary and sufficient condition that efficiency improves when more real output can be realized with a given amount of investible resources. Credit allocations that create linkages with the external sector without catalyzing the growth of the agricultural and manufacturing sectors of the economy would not generate the necessary sustainable developmental impetus in Ghana.

We look at the allocation of bank credit by broad categories of economic sectors. This is to indicate the redirection of credit, in a "before and after" analysis of FINSAP on credit allocation. Indications are that the services sector is the largest single sector, and indeed, the source of economic growth since the financial reforms. It is our basic hypothesis that the growth-leading role of the services sector has been facilitated by the flow of loanable funds to the sector.

To assess the basic hypothesis, we construct a credit allocation index that defines the pattern of change in bank credit to the various economic sectors. The indices are calculated as the ratios of credit proportions by economic sectors to GDP proportions by sectors.

Table 7 shows the pattern of credit allocation by broad categories of economic activity by type between the 1984-1996 period. An important feature exhibited by the table is the drastic reduction in the proportion of total credit to the agricultural sector. The percentage of total credit that went to the agricultural sector dropped from over 30 % in 1984 about 12 % in 1996. The drop is particularly important for the crops and livestock sub-sector where the proportion of credit that went to the sector fell from about 20% in 1987 to about 15% in 1988, the year of total financial liberalization, and then to the low level of 8.3% in 1993 and 1994.

The proportion of total credit that went to the industry sector did not show any consistent pattern. There was a declining trend in the three year period between 1984 and 1986. The next three years experienced increasing trends while the following two years saw reduction in credit to the industry sector. The rest of the period from 1992 to 1996 did not show any discernable pattern. A closer look at the sub-sectors of the industry sector however reveals an intriguing pattern. From 1987 to 1992, loans to the construction sub-sector have significantly increased from 11.5% to 17.9%. Though, it subsequently declined, it nevertheless was higher than the pre-FINSAP era. The manufacturing sector showed trends that suggest that apart from the years 1987-1989 and 1994-1996, credit proportions did not change significantly from the pre-FINSAP era. The story is however markedly different for the services sector. With the exception of 1986, the proportion of total credit

that went to the service sector was consistently higher than what prevailed in the pre-FINSAP era.

The trends in Table 7 suggest a redirection of credit away from the pre-FINSAP designated priority sectors such as agriculture and manufacture to the services sector. Beneficiaries of this shift include wholesale and retail trade, hotels, government services, and the construction sub-sector of industry. By implication, any shifts in the pattern of credit allocation between sectors would in part be explained by changes in the relative shares of GDP and the credit guidelines of the pre-FINSAP period.

The increasing trend in the ratios for the construction sector, wholesale, retail, hotels and government services confirm the profound shift of institutional credit towards those sectors perceived by the banks to be less risky.

However, underpinning the removal of the "visible hand" from credit allocation is the argument that the financial superstructure would accelerate economic development in so far as banks facilitate the allocation of funds to the best users. The assumption is that the invisible hand would allocate funds to those projects that have the highest social return. However, the policy dilemma with that assumption is that the social return on projects may not coincide with private returns which is the ultimate goal of private enterprises.

VII. The Development of the Regression Model

The foregoing discussion reveals the apparent dilemma for policy makers about the effectiveness of the financial sector reform on savings mobilization. The objective of this section is to ascertain whether the savings function can be explained by various variables that have been associated with savings mobilization in Asia, Latin American and other developing countries. A number of studies that use cross-section and time series data on national saving rates include Collins (1989, 1980, 1988), Giovannini (1983, 1985) and Gupta (1987). However, a few studies have used private sector savings to proxy for aggregate savings.

However, other studies include the level of per capita income as an explanatory variable for private savings. It is hypothesized that per capital income will have positive impact on saving rate. However, others argue that the distribution of income will also affect the savings function. In addition to real rate of interest as proposed by McKinnon (1973) and Shaw (1973), others also consider foreign savings as a relevant determinant of private savings.

In view of the exchange volatility in Ghana, this study proposed to include foreign exchange rate as an explanatory variable. In addition, it also hypothesized that high Treasury bill rate will attract greater savings to the government treasury bills. The inflation rate also is considered to have a greater influence on individual household's demand for money. As a result, inflationary impacts will have a significant impact on household savings.

Thus, the functional relationship between private saving rate and the above exogenous variables has been expressed as follows:

$$\mathbf{y} = \mathbf{X}\beta + \mathbf{u} \qquad (1)$$

where, **y** is the (N x 1) column vector of observations on the dependent variable. **X** is the (N x k-1) pre-determined variables, ß is k x 1 column vector of the regression parameters. **u** is (N x 1) column vector of N stochastic disturbances. The regression model is based on the assumption that the error term is normally distributed with zero mean and constant variance or homoscedastic distribution, (**U** ~**N(0,I)**). It is also assumed that there is no serial autocorrelation between the independent variables.

7.2. Data source and scope

Data for this study is from 1980 to 1995. This period has been dichotomized into two periods of pre- and post-reform periods. Both microeconomic and macroeconomic data will be collected over the above period. Data sources include: Bank of Ghana, Quarterly Economic Bulletin (various issues). 2. Ministry of Finance and Economic Planning, Statistical Service, Quarterly Digest of Statistics (various issues), 3. Central Bureau of Economic and Statistics Economic Survey (various issues), 4. IMF, International Financial Statistics

7.3. Hypotheses

We assume saving is determined by the rate of interest on deposit. Higher rate of interest on deposit induce higher saving rates. Generally, increases in the levels of income lead to higher propensities to save. Therefore, given a price level, higher income should lead to higher savings. It is assumed that high levels of inflation induce economic agents to increase the demand for money in order to maintain their standard of living. Such an inflationary environment discourages savings. A negative relationship exits between the level of saving and the level of inflation. Exchange rate is another determinant of the level of national savings. Theories on open economies suggest that favorable exchange rate lead to capital outflows and thus a reduction in national saving in a country. In other words, the higher the price of the local currency to the foreign currency the more economic agents save and invest locally. Finally, we introduce the rate of interest of alternative financial instruments available to the public as they are substitute-instrument to savings. The higher the rate of interest paid on the alternative financial assets compared to the deposit rate the less economic agents will save with the baking sector.

7.4. Measurement of Variables

We measure savings as Time and Savings Deposits for Deposit money banks. We use per capita GNP to measure the level of national income. We measure inflation rates as the rate of change in the level of Consumer Price Index. Deposit rates is the rate offered to resident customers for demand, time, or saving deposit as collected by the Bank of Ghana for the prudential returns of banks. The exchange rate is the unit of national currency per dollar. Finally, we approach the rate of interest, on alternative assets to Economic agents, with a treasury bill rate.

7.5. Testing Hypotheses and Inferences

The first step of the regression estimation and analysis is testing the unit root in order to detect nonstationarity[10] in the series (data). Using the Box-Jenkins approach, we found that the variables were stationary. The savings function is then estimated using SPSS computers statistical package for the entire period of the study (1980-95), the period preceding the structural adjustment (1980-88, and the period after the adjustment (1989-95.)

Overall, the F-statistics reveal a goodness of fit, of the model at the 5 percent levels of significance. High values of $\bar{R}^2$ are indication that the model explains a high percentage of variations in savings in Ghana. As a result of the high values of the coefficients of determination, we further introduced a time dummy variable in the equations to remove any spurious correlations among the variables. However, the results did not change significantly. The values of the Dubbin-Watson statistics differed largely forcing us to accept the null hypothesis of no autocorrelation for the pre-adjustment period and rejecting it for the entire period and the post adjustment period. We compiled the estimates of the equation in Tables 1 and 2. While per capita GDP is consistently a significant variable and positively related to the dependent variable for all the periods studied, the behaviors of the other variables vary from one case to the other.

Tests for the entire period show that deposit rate and inflation rate are significant determinants of savings. Deposit and inflation rates have positive coefficients as suggested by hypotheses. For the pre-adjustment period, only inflation rate is significant while deposit rate, treasury bill rate and inflation rate are significant in addition to the per capita GNP.

[10] i.e. whether their stochastic properties are invariant with respect to time i.e., if their means, variances, and autocovariances are independent of time.

Table 9.

Estimates of the Savings Equation

Variables	Entire Period 1980-95	Pre-adjustment 1980-88	Post-adjustment 1989-95
Constant	-2.48 (3.2)*	-1.88 (2.3)*	-6.19 (2.3)*
Deposit rate	-1.06 (0.6)	-0.29 (1.8)	30.44 (1.8)
Treasury bill rate	2.10 (1.7)	1.69	-25.19 (1.9)
Inflation rate	0.35 (2.7)*	0.08 (1.8)	-2.39 (1.8)
Exchange rate	0.07 (0.6)	-0.19 (0.4)	0.49 (0.4)
Per capita GNP	1.05 (18.3)*	0.97 (1.8)	2.62 (1.8)
R-square	0.98	0.99	0.99
Adjusted R-square	0.97	0.99	0.95
F-statistics	137.5	294.9	23.84
Dubbin-Watson	1.75	2.1	3.13

The numbers shown without parentheses are regression coefficients, while the numbers in parentheses are t-statistics. Asterisks suggest the coefficients are statistically significant at the 95 percent level of confidence.

Table 11.
Estimates of the Savings Equation (with significant variables only)

Variables	Entire Period 1980-95	Pre-adjustment 1980-88	Post-adjustment 1989-95
Constant	-2.78 (4.4)*	-0.62 (4.1)*	-6.99 (4.5)*
Deposit rate	1.65 (4.2)*		33.44 (2.8)*
Treasury bill rate			-27.32 (2.8)*
Inflation rate	0.33 (2.7)*	0.20 (2.5)*	-2.44 (2.4)*
Exchange rate			
Per capita GNP	1.0 (21.7)*	0.96 (41.0)*	3.18 (5.3)*
R-square	0.98	.0.99	0.98
Adjusted R-square	0.98	0.99	0.96
F-statistics	210.1	841.7	49.32
Dubbin-Watson	0.91	1.67	3.04

The numbers shown without parentheses are regression coefficients, while the numbers in parentheses are t-statistics. Asterisks suggest the coefficients are statistically significant at the 95 percent level of confidence.

VIII. Conclusion and policy implications

The findings of this study show that the financial sector reforms had a considerable impact on the capacity of the Ghanaian banking sector to mobilize financial savings. Furthermore, the study shows that despite the emergence of new banks the macroeconomic environment and government fiscal and monetary imbalances tend to constrain savings mobilization. The first important observation is the financial disintermediation caused real negative interest rates and the lack of confidence in the financial sector. Second, the frequent and excessive devaluation of the Cedi has caused Ghanaians to save less as observed in the post-adjustment period. Indirectly, economic agents were observed to increase their savings in foreign currencies as a hedge against the constant devaluation of the Ghanaian local currency.

The Ghanaian experience with financial reforms has supported the general notion that financial reform carried out in countries with unstable macroeconomic environment of high inflationary pressures has less chance of success than in those countries where macroeconomic stability prevails at the time of financial sector reform. In the case of Ghana, liberalization of interest rates has resulted in negative real rate of interest . This has produced a dis-incentive for financial saving. In addition, liberalization of the exchange rate in an inflationary environment has led to constant depreciation of the cedi and has created a volatile foreign exchange market. This is evidenced in the increasing process of Dollarization in Ghana.

A precondition for efficiency of a deregulated financial sector is stable macroeconomic policies at the time of the financial sector reform. Thus, in order to ensure effective financial development, the role of government deficit financing has to be controlled. There is the need for legislative limits on government fiscal deficit and borrowing from the financial markets.

Furthermore, the Central Bank must have a reasonable degree of independence in the conduct of monetary policy. In this regard, the Central Bank must be free to use its instruments to attain broad targets which may be set by the government. In particular, interest rate policy must be freed from governmental influence so that it can be effectively employed in response to actual or anticipated developments in the monetary situation.

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IMPROVING TRANSPARENCY IN TAX ADMINISTRATION

Case study: Madagascar

Major findings of the study

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January 1998

accounts base, the only ones available before finalising the current reforms), and on data from "Industrial Survey/1994 fiscal year", accomplished by the MADIO project.[1]

Considering the availability of data, the assessment covers the following fiscal instruments :

-IBS (Taxes on company profits)
-IGRNS (General taxes on income other than salaries)
-TST (Commercial transaction levy)
-TUT (Internal commercial transaction levy)
-TUT (External commercial transaction levy) and
-Import duties, including custom duties

One can see from Table 1 below that the theoretical collections (taking legal exemptions into account) were to the order of 1371.6 billion. The real figures were to the tune of 568.6 billion ; tax evasion for the fiscal instruments used (external and internal revenue) is estimated, for the year 1994, at 803 billion, 8.8% of the GDP. It should be noted that instruments not taken into account include specifically, income taxes, property taxes, domestic taxes (including those collected by the RMMF) and the TUPP.

The third part covers property taxes : an analysis of , on the one hand, characteristics of property taxation in Madagascar ; a presentation, on the other hand, of results of a mini-survey on the attitudes of tax-payers vis-a-vis these taxes in the city of Antananarivo.

-Property taxation in Madagascar is composed of three major taxes : land ownership tax (IFT), building ownership tax (IFPB) and a subsidiary tax on buildings (TAFPB). These are the annual direct taxes whose products are intended to fill the coffers of local authorities. They necessitate that rate-payers submit returns annually. This declaration system encourages tax evasion through :
-understating property and rental values ;
-systematic neglect by rate-payers to fulfil their declaration obligations
-inadequacy of fiscal census : the latest census in Antananarivo was done in 1975 ;
-the complexity of the collection system : it is the duty of the Treasury in conjunction with the relevant municipal services to collect rates, whereas establishing the tax data base is the responsibility of the revenue services. Municipal agents are put at the disposal of tax collectors from the Treasury to disseminate tax and prosecution notices. Thus, the collection of property taxes involves a multitude of officials whose actions are not always co-ordinated.

-The mini-survey done on a sample of 300 people, owners and tenants throughout the

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[1] MADIO, "Madagascar-Dial-Instat-Orstom", is an Instat support project ,externally funded.

Table 1 - ESTIMATED EVASION OF CERTAIN TAXES IN MADAGASCAR, 1994

(billions of Malagasy francs (MF), except percentages)

Type of tax	Tax rate: Industry	Tax rate: Services	Tax rate: Others	Theoretical base: Industry	Theoretical base: Service	Theoretical base: Total	Theoretical receipts: Industry	Theoretical receipts: Service	Theoretical receipts: Total, with or without exemptions: W.o.	Theoretical receipts: Total, with or without exemptions: With	Actual receipts	Evasion: MF	Evasion: Percentages of theor. rects	Evasion: Percentages of GDP	Effective tax rate
DOMESTIC TAXES															
Tax on company profits (IBS)	35%	45%		160	585	745	56	263	319	319	69	251	78.5%	2.7%	9.2%
VAT (TUT)	15%	15%		245	1010	1254	37	151	341	188	118	79	37.1%	0.8%	9.4%
Transactions Tax (TBT	7%	11%	7%	895	1339	2234	63	147	210	210	59	151	71.8%	1.7%	2.6%
General tax on non-wage income (IGRNS)	25%	25%		89	472	561	22	118	140	140	9	131	93.8%	1.4%	1.6%
Sub-total, domestic taxes				1388	3406	4794	177	679	1010	859	255	603	70.3%	6.8%	8.3%

	Tax rate: Raw mats.	Tax rate: Non-food consump goods	Tax rate: Capital goods	Theoretical base: Raw mats.	Theoretical base: Non-food consum goods	Theoretical base: Capital goods	Theoretical base: Total	Theoretical receipts: Raw mats.	Theoretical receipts: Non-food consump goods	Theoretical receipts: Capital goods	Theoretical receipts: Total, with or without exemptions: W.o.	Theoretical receipts: Total, with or without exemptions: With	Actual receipts	Evasion: MF	Evasion: Percentages of theor. rects	Evasion: Percentages of GDP	Effective tax rate
TAXES ON FOREIGN TRADE																	
VAT (TUT)	15% [of all taxable imports, including import taxes & customs duties]						1336				318	200.4	143	58	28.7%	0.6%	10.7%
Import levies (import taxes & customs duties)	10%	30%	20%	345	329	441	1115	34	99	88	364	221	157	65	29.2%	0.7%	14.1%
Export levies (DTE) levy per kg. vanilla	$20			261			261	95			95	95	14	80	84.9%	0.9%	5.5%
Sub-total, taxes on foreign trade							2711				777	516	314	202	38.2%	2.2%	11.6%
TOTAL, DOMESTIC & FOREIGN TRADE TAXES							7506				1787	1374	569	805			
TOTAL AS % OF GDP = 9131															58.6%	8.8%	7.6%

various sections of the capital city, would give an initial indication as to the level of information and tax awareness with regard to property tax as well as the perception and aspirations of the tax-payer in the same regard :
The majority indicated that they submit their tax returns regularly, that they pay their property taxes regularly ; with regard to questions concerning categories of tax-payers susceptible to tax fraud and the most frequently abused taxes, the responses varied considerably from one social category to another.
Comparative analysis of apartment rentals obtained from surveys and the amounts declared to the tax administration by the property owners reveals more interesting and telling information :

	Annual average rental according to surveys	Annual average rental according to tax declarations
Poor residential areas	881.579 Fmg	414.242 Fmg
Middle class residential areas	1.800.000 Fmg	945.070 Fmg
Upmarket residential areas	6.743.333 Fmg	2.571.000 Fmg

Legislation and the practice of tax exemptions are the subject of the forth part of the report :

-Tax exemptions generally granted for economic reasons (to encourage certain activities and operations) or on social grounds (to protect certain categories of tax-payers), affect the various categories of taxes namely, income tax, taxes on goods and services and duties and taxes on foreign trade. Onto these, should be added exemptions stipulated in the "Code on investments and the industrial free-trade zones". Some exemptions are equally the result of bilateral and multilateral agreements.

The recent changes in registration in that regard are characterised by the following measures :
-elimination of exemptions in terms of financial revenue within the framework of taxes on goods and services in 1994 ;
-application of a minimum rate of 1% on free-trade areas ;
-amendment of regulations on VAT, leading to a considerable reduction in the number of exempted products and the abolition of tax credit transfers ;

-In practice, the granting of exemptions is done either within the framework of periodic declarations or at the tax-payers request ; the authorities empowered to grant these exemptions include the Ministry in charge of tax regulation and, by official mandate, heads of department of the tax or customs administration.
This granting is often perceived as a way of dodging taxes and as a transaction stake between the administration and the ordinary tax-payer.

The practice of customs exemptions on which we have detailed statistical data for the years 1995 to 1997 enables one to raise the question regarding the consistence of the practice of exemptions with social goals.

Table 2 : Losses due to the implementation of customs duty exemptions (1995-1997)

in millions of FMG

	1995	1996	1997 (6 months)
Donations and aid	82497	13384	16662
Total exemption	13240	8689	27937
Technical assistance	22421	18748	12831
Investment code	81383	87807	21064
Partial exemption	138926	67159	10856
Grey areas	961	539	84
Total	339428	198326	89434
GDP (billion FMG)	13639.9	16244.3	
Tax revenue (billion FMG)	1120	1374.2	
Total % age of GDP	2.48	1.22	
Total % age of tax revenue	30.3	14.43	

Source : Customs office

It emerges from Table 2 that losses due to custom exemptions constitute 30.3% of tax revenue and 2.48% of the GDP in 1995 ; the corresponding percentages for 1996 are 14.43% and 1.22% respectively.

In 1995 and 1996, exemptions due to "partial exemption" (applicable to " dispatches of non-commercial value", in actual fact "discretionary") and the investment code represented more than half the total "losses".
It is thus relevant to question the consistence of the practice of custom exemptions with regard to social goals (education, health, fight against poverty).

The perception of tax evaders discovered in the course of a mini-survey covering 230 businesses in Antananarivo is dealt with in the sixth part of the final report. On the whole, responses tend to reflect the thoughts generally expressed by public opinion :

-The principal defaulters belong to the indo-pakistanese minority group ;
-The main factors for fraud are : administrative shortcomings, corruption and high tax rates ;
-The highest incidence of evasion occurs in commercial activities ;
-The taxes most hit by evasion are those imposed on goods and services, with specific regard to domestic taxes, customs duty, as far as external revenue is concerned ;
-Principal cases of fraud include fraudulent importation and sales without invoices ;
-Only fifty-three percent of respondents indicated that they were aware of the laws and the regulations concerning taxes, since they read the Government gazette regularly or occasionally.

The "tax payer base survey" was followed by a "tax administration survey". Tax and customs administrations are presently being restructured (in view of a more functional rather than an administrative assignment of tasks). The later survey was conducted in less ideal conditions. The following are the most significant responses :

a)The main causes of evasion are :
-lack of information and education on taxes
-tax-payers mentality
-lack of administrative resources
-shortage of officials (due to lack of training)
-communication and availability problems on the part of tax services (distant location of offices)
Trade, speculative activities and the informal sector are considered to be the areas where tax evasion is most rife.
b)The following are indicated has the most common tax evasion practices :
-sales without invoices or under -invoiced sales
-under statement of income and turnovers
-abuse of VAT reduction rights
c)In the course of their duties, the agents appear to encounter various difficulties, namely :
-lack of training
-the use of computer-based accounting systems by businesses
-the problem of implementing the provisions of the general code on taxes
d)-The majority of agents who where interviewed indicated that the following are partly founded :
-allegations accusing tax officials of incompetence, abuse of power and corruption,
-allegations according to which tax services never question the real tax evaders and that it is always the same people who pay their taxes

Taking the proposals of the Supervisory committee into account, the following recommendations have been made :

a)- To improve the information of tax-payers
This objective calls for the speedy establishment of a strategy and an information structure for the tax-payers with the effective participation of professional associations and other components of civil society. The said structure shall be responsible for :
The dissemination of tax laws and their implementation texts ;
The publication in an official gazette of decisions concerning the application of tax laws and regulations.
Any decision on principle and interpretation not published in the official gazette should not be put forward the tax-payer.

The publication of dispensations and exemptions granted by the administration, including the decisions of the "Administrative transaction commission", created in 1994.

The publication of the list of tax-payers who have committed specific infringements,

recognised as such by the tax and customs administration, and the penalties exacted against them.

d) Regular information to the tax-payers regarding the rates of tax collection and tax evasion. Going by the method exemplified in section 2.3 of this report, information can be given either globally or by tax categories. In the current government structures, the service equipped for this task would be the Permanent Secretariat for Macroeconomic Forecasting (SPPM), of the Ministry of Finance and Economics.

Aims of the study:

In the definition and implementation of a policy geared to growth and equity, it is necessary, with respect to internal balance management, to lay emphasis on the control of the fiscal deficit.

Within the framework of this research, fiscal deficit control is examined from the revenue viewpoint. In the case of Madagascar, such an approach is even more recommended, considering that for a number of years the country has been experiencing a pronounced downward tendency in fiscal performance.

The objective is to contribute to the improvement of the performance of the tax administration. Such an improvement would entail reforms in the tax system as well as reinforcing the tax administration. The various options regarding these aspects are not explicitly explored in this study.

The main aspect here is reinforcing the transparency of the tax administration. To this end, the following assumption is made : sufficient information given to the public on the nature of the weakness of the tax administration and the extent of tax evasion would lead to an increase in revenue collection and improvement in the performance of the administration.

The final report is composed of seven parts :

The first part reviews recent studies on the Madagascar tax system, with a view to recalling the main factors for the decline in fiscal performance. It emerges that the global taxation rate (relation of the sum of fiscal and para fiscal deductions and the GDP) decreased from 14,6% in 1987 to 8,4% in 1995, and that the following are the main factors for the decline in fiscal revenue :

The cancellation of export duties, representing a loss in tax revenue of 4 to 5% of the GDP. This cancellation was not linked to an improvement in internal tax revenue ;

Deficiencies on the part of the administration regarding specific taxes
This concerns IBS (tax on company profits) and the IGRNS (general tax on income other than salaries) which are direct taxes. The following are the main deficiencies : failure to cover tax payers not only in the informal sector but also in the formal sector ; inability to examine tax returns whereas under estimation of income is obvious.

Deficiencies of the administration regarding the collection of indirect taxes :
TUT (commercial transaction levy) whose characteristics are similar to those of VAT et TC (consumption taxes) which are excise duties.
The revenue services for direct and indirect taxes have neither the means to

deal with all defaulters nor the capacity to examine tax-payers returns.

On the other hand, multiple exemptions renders the management of these taxes difficult and affect their yield .

The administration reacted to the decreasing tax yields by gradually increasing taxation rates. High taxation rates seem to have worsened tax evasion.

Inadequate organisation and means for the tax administration.
The above deficiencies can be attributed to inadequate means for the tax (and customs) administration, poor organisation at central level and the complexity of the tax system.

The second part deals with tax evasion estimates : the limitations of the current methods for budgetary projections used by the administration are analysed. Then, two independent methods for the assessment of tax evasion are presented :

The projection methods of the administration are based on the main economic categories and not on their legal fiscal denominations. These are the main income categories :
internal revenue:
tax on income and profit (IRG)
tax on goods and services (IBES)

(ii) external revenue:
export taxes and duties(DTE)
import taxes and duties(DTI)

Their changes are based on the changes in the GDP or the price index. For example :

IRG=GDPCF * K 0,015<K<0,018, where the GDPCF is the GDP at factor cost, and K the previous revenue IRG in % of the GDP.
This method leads to the confirmation of the decline in physical performance and to the carrying over to the year N tax evasions from fiscal years N-1, N-2, N-3.
The DTI and the DTE projections based on the import and export figures of the year in review are closer to reality.

An independent assessment of tax evasions for the year 1994 is presented in this report. The term independent refers to estimates based on accounting macro-economic data and not on data provided by the administration. In this regard, assessment is based on an EGC(2.2) model.

It is based on national accounts (with constant reference to the 1984

1/95

INTERMEDIATION FINANCIERE & PAUVRETE

Au Sénégal

Document 1/2

ASPECTS INSTITUTIONNELS

Etude réalisée dans le cadre du programme EAGER

USAID – Washington

REMIX

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INTRODUCTION

Elle est révolue l'époque où la question de la pauvreté n'interpellait que quelques âmes sensibles ou "aristocrates en quête d'humanisme". Le problème, aujourd'hui est au centre des grands débats internationaux, et continue à faire couler beaucoup d'encre. Plusieurs études ont été consacrées à l'analyse et à la quantification de ce phénomène au Sénégal. Elles ont permis de mettre en évidence le fait que les insuffisances du système financier (rationnement sévère du crédit, inexistence de certains produits financier, orientations inefficaces du crédit, maturité inadéquate, etc.) ne sont pas sans effets sur les processus de création de richesses et de formation de revenus des populations.

C'est un fait, les pauvres ne constituent pas une race à part, vivant dans un monde à part. Et, à en croire aux données de la Banque mondiale, près de 3/5 de la population mondiale vit en dessous du seuil de pauvreté dont plus de 1,3 milliards, dans une situation d'extrême, avec moins de 1 Dollar par jour. Des études prospectives menées par des experts de cette même institution, relèvent une accentuation de la situation d'année en année, tant du point de vue qualitatif que quantitatif.

S'il est permis de comprendre que l'augmentation de la consommation conditionne l'augmentation de la production, il est aussi aisé d'admettre qu'une régression continuelle du nombre de consommateurs contraint, à terme, le potentiel des producteurs. C'est ainsi traduit là, une première raison de l'actualité du débat.

D'autre part si, sous un angle sociologique, on peut comprendre que "ventre affamé n'ait point d'oreilles", on perçoit tout de suite, et c'est la seconde raison, la menace que la situation de pauvreté pèse sur l'équilibre et la sécurité du monde des affaires et du monde tout simplement. En témoigne la montée de la violence dans la nouvelle République du Congo "ex Zaïre" et la menace qu'elle pèse sur les intérêts de grandes entreprises américaines et européennes, évoluant dans les zones diamantaires de Lumbubashi ou du Kivu. En témoigne aussi, les génocides en Afrique, la montée de la criminalité enregistrée dans des villes comme New York, l'apparition et la propension du quart monde occidental etc.

Dans le contexte de mondialisation de l'économie caractérisée par l'automatisation de la production et le développement des marchés financiers via les autoroutes de l'information, il y a consensus sur le fait que la micro finance constitue une réponse plausible à l'impérieuse satisfaction des besoins économiques des pauvres. La micro finance, c'est la finance à une échelle plus basse. Sa mise en œuvre nécessite des relais. Déjà, l'intermédiation financière traduit le passage, la circulation de la finance d'un endroit à l'autre, d'une situation à une autre, d'une optique temporelle courte à une optique plus large. Mais la circulation traduit

aussi l'idée de cercle. Autrement dit dans le système de l'intermédiation financière, l'argent doit aller dans un sens, revenir dans l'autre, et vice versa.
L'État, dans ce système, joue le rôle des feux de signalisation dans la circulation automobile des villes. Pour peu qu'il y ait des lumières qui ne s'allument pas, parce que grillées ou mal programmées, c'est l'embouteillage.
De même, si pour une raison ou une autre, l'automobiliste qu'est l'intermédiaire financier dans le cas d'espèce, n'a pas une bonne maîtrise de sa mécanique ou de son fonctionnement, non seulement il embrouille la circulation, mais il met aussi en danger la sécurité des autres usagers. Cela reste aussi valable pour le piéton, client du système, qui ne respecte pas les règles du jeu.

L'approche de la problématique du rapport micro finance et pauvreté n'est pas toujours aisée. Plusieurs études ont porté sur la question. Plusieurs expériences ont été initiées. Certaines ont plus ou moins réussi, d'autres ont échoué pour des raisons liées tantôt à l'environnement juridique et réglementaire, tantôt au fonctionnement des institutions, tantôt à la compétence managériale des intermédiaires financiers, tantôt à l'indiscipline financière des emprunteurs...

Dans l'action, nous avons opté pour une approche systémique, requérant une démarche globale. Nous sommes largement inspirés des expériences des uns et des autres. Nous sommes enrichis de différents écrits de chercheurs qui nous ont précédés et d'entretiens que nous avons tenus avec des professionnels, opérateurs du secteur mais aussi avec certaines autorités chargées de la réglementation. Aussi, loin de vouloir apporter des solutions inéluctables à la problématique de l'intermédiation financière à l'endroit des pauvres, notre tâche n'aura été que de voir les solutions les plus probables.

L'étude dont les résultats sont transcrits dans les pages qui suivent, a été réalisée par notre cabinet, sous la supervision d'un comité de pilotage composé d'éminents chercheurs et professionnels, de la finance, de la micro finance et des questions sociales. Elle s'inscrit dans un vaste programme de recherche initié par le bureau Afrique de l'USAID à Washington (programme EAGER). Sous la maîtrise d'œuvre de l'Université de Harvard, le pilotage a été assuré par la DAI. Dans la même période où nous la réalisions au Sénégal, une démarche similaire a été entreprise en Afrique du Sud. Les différents résultats devront être consignés dans un document commun et, portés à la connaissance de la communauté de recherche internationale et des autorités compétentes.

L'étude en question porte sur deux volumes: un sur les aspects institutionnels et un autre sur les produits et modèles financiers.

La premier document est subdivisé en 4 grandes parties. Dans la première, il sera question d'identification et de cadrage des pauvres aux Sénégal. Il va ensuite s'agir d'examiner le cadre politique et réglementaire qui régit le système financier sénégalais afin de mieux apprécier les éléments qui favorisent ou contraignent la finance pour les pauvres. Dans la troisième partie nous allons essayer de voir comment le système financier décentralisé s'articule avec les us et coutumes financières des populations pauvres. Enfin, partant des enseignements tirés des premiers niveaux d'analyse, nous essayerons de formuler des recommandations allant dans le sens d'une meilleure intermédiation financière intégrant cette population démunie.

Dans le second il s'agira de partir de certaines expériences locales jugées relativement performantes et proposer des éléments d'amélioration à même d'inciter un fonctionnement optimal du système intégrant des éléments d'accessibilité et de viabilité.

CHAPITRE I - LA PAUVRETE AU SENEGAL

I - CONSIDÉRATIONS GÉNÉRALES

Au Sénégal, les activités financières formelles sont fortement concentrées dans un secteur restreint. Ce contrôle du système financier formel par un nombre très limité de banques ou de guichets a eu pour conséquence d'en exclure une proportion importante de la population. Les pauvres sont les plus touchées par cette exclusion du fait des longues procédures bancaires et de leur incapacité à mobiliser les garanties et les apports personnels exigés par les banques. Cette exclusion limitent considérablement la capacité de réduction de la pauvreté du gouvernement. Pourtant, la lutte contre la pauvreté a toujours été la préoccupation centrale des politiques ou actions économiques et sociales de l'État.
Dans la littérature, la notion de pauvreté apparaît avec force. Le gouvernement de la république du Sénégal a élaboré récemment un document sur la stratégie nationale de lutte contre la pauvreté. Ce document indique l'ampleur du phénomène en ces termes :

> *" Il y a au Sénégal 30 % de ménages vivant en dessous du seuil de pauvreté qui est défini comme étant la dépense nécessaire à l'acquisition de 2.400 calories par jour et par personne dans le ménage. 75 % des ménages pauvres sont localisés en milieu rural alors que la population rurale représente 60 % de la population totale. 58 % des ménages ruraux sont pauvres ".*
>
> MEFP – Direction de la Planification Stratégie nationale de lutte contre la pauvreté, page 4

C'est donc dire que cette exclusion du système bancaire et financier formel touche une proportion importante de la population, surtout en zone rurale. Cette exclusion traduit une incomplétude du système financier formel (en termes d'institutions et de produits financiers) dans la mesure où les pauvres ne trouvent pas de produits financiers compatibles avec leurs besoins d'allocation spatio-temporelle de ressources dans le circuit formel. Cette demande non satisfaite de produits financiers est source d'inefficacités. Cette inefficacité de l'intermédiation limite la contribution des pauvres et surtout des ruraux à la croissance économique. A titre d'illustration, la population rurale que regroupe 60% environ de la population totale du Sénégal ne contribue au PIB qu'à concurrence de 11%.
La promotion de prestations de services financiers à l'adresse des pauvres entre dans le cadre des programmes de lutte contre la pauvreté ; elle permettra de réduire les inefficacités du système financier et les comportements de sous-investissements qui en découlent. L'intégration des pauvres dans le système financier formel dépend de sa capacité d'innovation en matière financière. L'innovation financière, elle, nécessite une identification fine de la population cible de par son importance, sa répartition entre les régions du pays mais aussi selon son profil de revenus. De la précision de ce travail

d'identification dépendra l'adéquation des services financiers proposés aux pauvres. L'identification des pauvres est tributaire de la définition de la pauvreté.

Les développements qui suivent présentent les principales approches de définition et de quantification de la pauvreté que fournit la recherche économique. Ils permettront de procéder ensuite à la quantification de la pauvreté au Sénégal et à l'érection du profil de pauvreté au Sénégal. Les propositions de produits et de modèles financiers découleront de la compréhension que nous aurons du phénomène de la pauvreté au Sénégal.

II - INDICES ET PROFILS DE PAUVRETE AU SENEGAL

L'identification d'une population pauvre nécessite une méthode de quantification du bien-être ou de l'utilité des individus. Elle ne peut également se faire sans la détermination du niveau de bien-être ou d'utilité en deçà duquel un individu est jugé pauvre. Différentes approches conceptuelles se concurrencent pour tenter de mesurer le bien-être d'un individu. Elles diffèrent selon l'importance accordée par l'analyste au jugement que l'individu attache à son bien-être mais aussi en fonction de l'importance donnée à l'idée de niveau de vie mesurée en termes quantitatifs plutôt que qualitatifs. Ces différences d'approches déterminent les processus d'identification des populations pauvres et de mesure du phénomène. Au delà de ces divergences conceptuelles, le choix d'une méthode de mesure doit se faire en ayant à l'esprit les actions ou stratégies envisagées pour lutter contre la pauvreté. En effet, la mesure de la pauvreté dans une société n'est pas une fin en soi mais a pour perspective la mise en œuvre d'une politique de lutte contre la pauvreté. Les stratégies favorisant l'amélioration de la capacité des pauvres à accroître leurs revenus et facilitant la financiérisation de cette population se conçoivent comme étant des actions de lutte contre la pauvreté en ce sens qu'elles sont créatrices de richesses. La perspective de mise en œuvre de telles stratégies n'autorise pas de fonder la mesure de la pauvreté sur les perceptions subjectives que les individus ont de leur situation. Il importe à cette fin de s'accorder sur une ou plusieurs variables dont la privation absolue ou relative fait d'un individu un pauvre. Cette variable peut être le revenu, la richesse, la consommation, les conditions d'habitat, l'accès aux soins de santé ou au réseau de fourniture d'eau potable, etc.... En pratique, les conclusions en termes de mesure de la pauvreté ne varient pas selon que l'on choisit l'une ou l'autre de ces différentes variables. En théorie cependant, rien n'empêche de penser qu'un individu ayant un niveau de revenus ou de richesses lui permettant d'accéder à un panier de consommation riche et variée ne choisira pas plutôt une consommation pauvre. Ces comportements peuvent être observés de façon marginale ; ils ne peuvent cependant être érigés en règle. Le choix de l'une de ces variables pour procéder à la définition et à la mesure de la pauvreté découle de la disponibilité des informations qui leur sont relatives.

En général, les enquêtes sur les ménages sont la source essentielle d'informations sur ces variables. Une telle enquête a été menée au Sénégal par la Direction de la Prévision et de la Statistique (DPS) : l'enquête sur les priorités (ESP). Une enquête plus exhaustive (ESAM) la complète, mais ses résultats ne sont pas publiés à ce jour. Plusieurs travaux ont été faits sur les quantifications de la pauvreté au Sénégal sur la base de l'ESP; cette étude s'inspirera des conclusions de ces travaux pour se prononcer sur les manifestations de la pauvreté au Sénégal, sur sa répartition zonale (urbaine – rurale), régionale, par genre, etc. mais aussi sur les déficits relatifs en principaux biens essentiels de la population sénégalaise pauvre.

La promotion de services financiers à l'adresse des plus démunis nécessite une évaluation fine de la situation de ces derniers. Une telle évaluation permet d'éviter la conception de services financiers inadaptés aux besoins des pauvres. Elle facilite, pour les initiateurs des actions micro financières, la détermination des zones d'intervention prioritaires, grâce à une estimation de la distribution spatiale de la pauvreté au Sénégal. Elle permet enfin, grâce à l'évaluation des manifestations de la pauvreté, de prévoir l'utilisation probable que feront les plus démunis des richesses que les contrats financiers leur permettront de créer. La structure de ces contrats financiers devra donc tenir compte des déficits de cette frange de la population relativement aux principales variables de pauvreté.

Il est généralement admis de retenir comme principales variables de pauvreté l'alimentation, l'éducation, l'habitat, l'accès aux soins de santé, l'accès à l'eau potable (réseau Sonees), et le revenu. Une étude récente[1] retient pour ces variables les seuils suivants :

Alimentation :	2.400 calories / jour / équivalent adulte
Logement :	50 % de la moyenne nationale
Education :	20 % de la moyenne nationale
Réseau Sonees :	accès à ce réseau
Santé :	accès aux soins de santé publique
Revenu :	50.000 francs cfa / mois par ménage de 6 personnes ou plus

Le choix de ces seuils permet d'établir le profil de pauvreté au Sénégal selon les variables retenues. Ce profil est donné par le tableau qui suit. Cette présentation du profil de pauvreté retient les ménages en tant qu'unités statistiques. Les éléments d'une colonne j du tableau (j = santé, alimentation, scolarité, Sones[2], habitat) indiquent le nombre de ménages pour lesquels la modalité prise par la variable d'intérêt est en deçà du seuil fixé pour cette variable. C'est donc le nombre de ménages jugés pauvres relativement à cette variable. On

[1] Etude sur l'identification des bénéficiaires du PNLP / SALL Consulting – PAGD – Direction du Plan

[2] Société Nationale d'Exploitation des Eaux du Sénégal

obtient ainsi une approche multidimensionnelle de la pauvreté au Sénégal. Par souci de simplification, et sous hypothèse de rationalité des individus, le lien existant entre les différentes variables retenues permet de se ramener à une approche unidimensionnelle qui permet de quantifier plus directement le marché potentiel des structures ciblant les pauvres. Pour minimiser les erreurs d'exclusion *(considérer un individu pauvre comme un individu riche)* on peut retenir comme variable de synthèse la variable pour laquelle on recense le plus grand nombre de pauvres : l'habitat. Ainsi, sur les 837.000 ménages environ que compte le Sénégal, 720.000 environ seraient des clients potentiels des SFD dont 420.000 vivant en milieu rural et 300.000 en milieu urbain. En supposant qu'en moyenne dans chaque ménage trois personnes *(les études statistiques montrent que le ménage moyen sénégalais est composé de 8,5 personnes)* ont le droit de contracter avec une SFD, on arrive au chiffre de 2.160.000 individus pauvres, clients potentiels pour les structures de micro finance. Cet important marché potentiel montre que même si la marge unitaire sur les opérations micro financières est faible, cette activité peut bénéficier d'importants gains grâce à l'échelle des opérations. Au-delà de la relative insuffisance de revenus caractérisant les clients ciblés par les activités micro financières, ces clients potentiels présentent des profils différents dont la bonne connaissance par les offreurs de produits financiers permet de dénouer les contrats dans les meilleures conditions. Ainsi, sur les 720.000 ménages que l'on peut considérer comme étant la population cible, 275.000 ménages (soit 825.000 individus selon nos hypothèses correspondant à trois individus *capables* par ménage,) demanderont des produits financiers pour combler leur déficit alimentaire, 376.000 pour améliorer l'éducation de leurs enfants ou leur propre instruction, 30.000 ménages souhaiteront accéder aux soins de santé et 40.000 à l'eau potable. En d'autres termes, les contrats financiers demandés présenteront des caractéristiques (échéancier, montant, maturité, garanties attachées, rapidité, etc.) aussi différentes que les besoins essentiels qu'ils devront contribuer à satisfaire.

Tableau 1 : Profil de la pauvreté au Sénégal

Département	Alimentaion	habitat	Scolarité	Santé	Sonees	Revenu 0,5	Population de la zone	Pop dpt j en % popul.du sénégal	Banques & Etabl. Fin.
Dakar	18679	84023	13413	1527	2165	540	104048	12,43%	27
Pikine	9128	68113	21520	726	7437	458	75562	9,03%	1
Rufisque	831	17831	3695	584	165	123	19237	2,30%	1
Bignona	14314	16699	4924	657	20485	161	23460	2,80%	0
Oussouye	3867	2297	360	483	4836	19	4836	0,58%	0
Ziguinchor	7160	19937	7161	1519	20482	218	25039	2,99%	4
Bambey	8442	21687	14765	124	16949	160	23374	2,79%	0
Diourbel	4821	18450	10002	663	10360	189	20828	2,49%	1
Mbacké	2324	25089	21005	0	6488	192	28040	3,35%	1

Dagana	1228	27673	11844	45	10807	227	31706	3,79%	4
Matam	6794	26586	20405	2063	24760	232	30174	3,61%	1
Podor	1509	18064	9946	0	14505	163	20142	2,41%	1
Bakel	6066	11301	7701	1203	7326	81	14338	1,71%	0
Kédougou	6900	7052	4714	1597	5999	77	7853	0,94%	0
Tamba.	11738	20993	12702	2643	21408	188	25900	3,09%	3
Kaffrine	23269	33463	27224	6195	25525	302	37945	4,53%	0
Kaolack	12382	30688	14204	1945	12783	332	34620	4,14%	4
Nioro	9482	16432	12476	1355	14879	159	18351	2,19%	0
Mbour	14460	36705	17173	686	21019	202	41025	4,90%	2
Thiès	6700	34548	17597	931	12812	273	38219	4,57%	3
Tivaouane.	7410	29182	19557	129	21851	188	31692	3,79%	0
Kébémer	5129	17974	13688	0	4833	173	19659	2,35%	0
Linguère	6048	13092	9798	0	7070	138	14907	1,78%	0
Louga	5141	17047	12466	64	9042	162	19954	2,38%	2
Fatick	15191	23262	8794	118	20256	196	25479	3,04%	1
Foundiougne	8824	13905	9781	192	13547	144	15165	1,81%	0
Gossas	8510	16753	12660	0	6879	125	17711	2,12%	0
Kolda	15015	19574	11523	1903	21746	184	22437	2,68%	2
Sédhiou	22854	26005	16369	2732	25635	195	29453	3,52%	1
Vélingara	10737	13663	8613	0	*15847*	118	15847	1,89%	0
Zone rurale	*226761*	*428012*	*296298*	*22883*	*356494*	*3660*	*482234*	*57,61%*	*0*
Zone urbaine	*48205*	*300090*	*79797*	*7214*	*51416*	*2279*	*354767*	*42,39%*	*59*
SENEGAL	*274966*	*728102*	*376095*	*30097*	*407910*	*5939*	*837001*	*100,00%*	*59*

Extrait de : Etude sur l'identification des bénéficiaires du PNLP / SALL Consulting – PAGD – Direction du Plan

Nous n'avons pas retenu la variable revenu compte tenu de la nature de cette variable. Les réponses des ménages relatives à cette variable sont biaisées et il est impossible de les observer. C'est ce biais qui explique la médiocrité des résultats obtenus sur cette variable. Les autres variables représentent cependant de bons " proxy " du revenu.

On peut raisonnablement penser que les ménages les plus pauvres sont ceux pour lesquels la modalité prise par la variable alimentation est inférieure au seuil défini. Ainsi donc, la pauvreté chronique est mieux rendu compte par cette variable dont la nature permet un minimum de degrés de liberté aux individus dans les décisions d'allocations des ressources disponibles entre leurs différents besoins.

Les stratégies de réduction de la sévérité de la pauvreté (en terme de nombre de personnes touchées) doivent être orientées vers les zones présentant le plus de pauvres relativement à cette variable (alimentation), soit respectivement le département de Sédhiou, Dakar, Fatick, Kolda, Mbour, etc. Il faut cependant noter que es stratégies micro financières orientés vers ces zones présentent en générales plus de risques en ce sens que les déficits alimentaires se traduisent souvent par de faibles productivités et des coûts relatifs des pénalités faibles en cas de non respect des contrats financiers.

Les stratégies qui visent la réduction de l'étendue de la pauvreté (pour toutes les variables doivent s'orienter vers les régions qui comprennent le plus de pauvres en valeurs cumulées. Ces stratégies sont compatibles avec des stratégies commerciales extensives pour des SFD visant une large population se donnant ainsi les moyens d'assurer leur pérennité malgré des marges unitaires faibles.

Le tableau suivant, tiré du précédent, donne la proportion de la population pauvre relativement aux différentes variables.

Tableau 2 : Indices numériques de pauvreté par localité et par variable

Département	Alimentaion	habitat	Scolarité	Santé	Sonees	Revenu 0,5
Dakar	17,95%	80,75%	12,89%	1,47%	2,08%	0,52%
Pikine	12,08%	90,14%	28,48%	0,96%	9,84%	0,61%
Rufisque	4,32%	92,69%	19,21%	3,04%	0,86%	0,64%
Bignona	61,01%	71,18%	20,99%	2,80%	87,32%	0,69%
Oussouye	79,96%	47,50%	7,44%	9,99%	100,00%	0,39%
Ziguinchor	28,60%	79,62%	28,60%	6,07%	81,80%	0,87%
Bambey	36,12%	92,78%	63,17%	0,53%	72,51%	0,68%
Diourbel	23,15%	88,58%	48,02%	3,18%	49,74%	0,91%
Mbacké	8,29%	89,48%	74,91%	0,00%	23,14%	0,68%
Dagana	3,87%	87,28%	37,36%	0,14%	34,09%	0,72%
Matam	22,52%	88,11%	67,62%	6,84%	82,06%	0,77%
Podor	7,49%	89,68%	49,38%	0,00%	72,01%	0,81%
Bakel	42,31%	78,82%	53,71%	8,39%	51,09%	0,56%
Kédougou	87,86%	89,80%	60,03%	20,34%	76,39%	0,98%
Tamba.	45,32%	81,05%	49,04%	10,20%	82,66%	0,73%
Kaffrine	61,32%	88,19%	71,75%	16,33%	67,27%	0,80%
Kaolack	35,77%	88,64%	41,03%	5,62%	36,92%	0,96%
Nioro	51,67%	89,54%	67,99%	7,38%	81,08%	0,87%
Mbour	35,25%	89,47%	41,86%	1,67%	51,23%	0,49%

Thiès	17,53%	90,39%	46,04%	2,44%	33,52%	0,71%
Tivaouane	23,38%	92,08%	61,71%	0,41%	68,95%	0,59%
Kébémer	26,09%	91,43%	69,63%	0,00%	24,58%	0,88%
Linguère	40,57%	87,82%	65,73%	0,00%	47,43%	0,93%
Louga	25,76%	85,43%	62,47%	0,32%	45,31%	0,81%
Fatick	59,62%	91,30%	34,51%	0,46%	79,50%	0,77%
Foundiougne	58,19%	91,69%	64,50%	1,27%	89,33%	0,95%
Gossas	48,05%	94,59%	71,48%	0,00%	38,84%	0,71%
Kolda	66,92%	87,24%	51,36%	8,48%	96,92%	0,82%
Sédhiou	77,59%	88,29%	55,58%	9,28%	87,04%	0,66%
Vélingara	67,75%	86,22%	54,35%	0,00%	100,00%	0,74%
Zone rurale	*47,02%*	*88,76%*	*61,44%*	*4,75%*	*73,93%*	*0,76%*
Zone urbaine	*13,59%*	*84,59%*	*22,49%*	*2,03%*	*14,49%*	*0,64%*
SENEGAL	*32,85%*	*86,99%*	*44,93%*	*3,60%*	*48,73%*	*0,71%*

source: calculs à partir de Etude sur l'identification des bénéficiaires du PNLP / SALL Consulting PAGD – Direction du Plan

Il s'agit des indices numériques de pauvreté calculés pour chaque département, pour les zones rurale et urbaine, et pour l'ensemble du Sénégal. L'examen de ce tableau permet de confirmer le caractère rural de la pauvreté au Sénégal. Pour toutes les variables, la proportion de pauvres est plus importante en zone rurale qu'en milieu urbain. Ainsi, 47,02 % de la population rurale soit 226.761 ménages ruraux consomment moins de 2.400 calories par jour et par équivalent adulte.

Les stratégies de réduction de la profondeurs de la pauvreté chronique consiste à orienter les activités micro financières vers les zones présentants les pires indices (population pauvre dans la zone / population totale de la zone) relativement à la variable alimentation. Il s'agit respectivement des département de Kédougou, Oussouye, Sédhiou, Vélingara, Kolda, etc.

Il n'y a donc de répartition optimale de l'implantation des SFD à travers le Sénégal. Cependant, pour un objectif donné (en terme de type de réduction de la pauvreté et de variable d'intérêt retenue), les autorité ou les bailleurs de fonds peuvent orienter l'implantation des SFD et leurs méthodes d'approche de la population grâce à un système d'incitation positive (subvention modulable selon l'implantation et le type de clientèle par exemple).

La réduction durable de la pauvreté exige cependant qu'une forte priorité soit accordée a l'éducation et à la santé des population démunies.

CHAPITRE II - CADRE LEGAL ET REGLEMENTAIRE

La crise des finances publiques et du système bancaire, constatée dans les années 1980, a touché la plupart des institutions financières africaines et a engendré, au Sénégal, la liquidation des banques en sérieuse difficulté, le désengagement de l'État dans le secteur bancaire ainsi que la mise en place d'un comité de supervision supranationale chargé de veiller au respect des pratiques en matière de gestion bancaire. Les efforts d'assainissement entrepris depuis lors se sont inscrits dans un vaste programme de libéralisation économique et financière et de renforcement de l'intégration économique sous régionale. Ils ont induit l'adoption d'une nouvelle loi bancaire qui vise une plus grande protection des épargnants et cherche à intégrer la dimension culturelle des pratiques financières des populations, en prévoyant, à coté des banques, l'existence d'institutions au sein desquelles les structures mutuelles et coopératives ont un statut particulier.

Dans cette même mouvance, avec l'appui de la Banque Mondiale et de l'Agence de Coopération Canadienne, il a été initié un projet d'assistance technique aux opérations bancaires mutualistes (ATOMBS) ayant pour objectif «d'identifier et de mettre en place les conditions devant faciliter l'émergence et le développement d'un système financier mutualiste, privé et autonome, à la fois propriété de ses adhérents et offrant toutes les garanties de saine gestion. ». Les travaux de ce projet en collaboration avec la BCEAO, ont facilité, en juin 1992, l'élaboration d'une loi cadre qui a mis en place un programme d'appui à la réglementation des mutuelles d'épargne et de crédit : la loi PARMEC, adoptée le 05 janvier 1995 par les autorités sénégalaises.

Cependant, en dépit de toutes les dispositions prises en vue de protéger au maximum la clientèle, faire jouer pleinement la concurrence et canaliser les pratiques financières informelles, le système mis en place ne correspond pas directement aux besoins des populations les plus démunies et, conséquemment, a un impact peu significatif sur leur mode et comportement financier.

Le but visé dans cette partie est d'analyser de manière succincte cet environnement politique, institutionnel et réglementaire qui régit l'activité financière au Sénégal. Cette analyse devra permettre de tirer les enseignements conduisant aux recommandations relatives à l'amélioration des conditions d'une meilleure intermédiation en rapport avec notre objet.

I - ELEMENTS DESCRIPTIFS DE LA POLITIQUE MONETAIRE

L'évolution de la politique monétaire dans l'UMOA au cours des trois dernières décennies peut être découpée en quatre grandes étapes :

De 1962 à 1975 : Conduite de la politique monétaire

A partir de 1975 : Réforme de la politique de la monnaie et du crédit

A partir de 1989 : Réaménagement des règles de gestion monétaire

A partir de 1993 : Nouveau dispositif de gestion monétaire

a - De 1962 à 1975 : Conduite de la politique monétaire

La politique monétaire de la BCEAO sur cette période, marquée par un environnement mondial commercial et monétaire relativement stable, était axée principalement sur le régime des limites individuelles et des autorisations de réescompte en faveur des banques. Cette politique était accompagnée par l'application de faibles taux d'intérêt. Ce système n'a pas été à même de contrôler la liquidité des économies et d'orienter les crédits vers les secteurs productifs. En outre, les bas taux d'intérêt avait eu un effet pervers sur la collecte et la mobilisation de l'épargne et sur l'établissement des réseaux bancaires hors des villes principales.

b - A partir de 1975 : Réforme de la politique de la monnaie et du crédit

Pour assurer le contrôle de la liquidité de l'économie, la BCEAO a été dotée de deux instruments : *le concours global* et *les réserves obligatoires*. Cependant, seul l'instrument *concours global* a été opérationnel jusqu'en 1993. Cet instrument a pour vocation d'assurer la cohérence entre l'évolution des sphères réelles et financière et celle des agrégats monétaires. Cet agrégat consiste à déterminer les niveaux des concours de la BCEAO et des banques primaires aux économies en fonction des évolutions anticipées des secteurs réels : production de biens et services, prix, finances publiques, balance des paiements. Cette politique a également permis de mettre en œuvre une politique sélective du crédit dans le but d'orienter les finances bancaires vers les secteurs jugés prioritaires grâce à un système d'autorisations préalables. Pour assurer le maintien des ressources intérieures de l'Union, un marché monétaire a été créé afin de recycler les excédents de trésorerie de certains établissements de crédit vers ceux en déficit de ressources. La création du marché monétaire a été accompagnée par une hausse des taux qui les rendaient comparables aux taux étrangers.

De 1975 à 1989, les orientations données à la politique monétaire étaient de concourir au financement des besoins du développement économique. Cette période a été favorable à la mise en œuvre de la réforme.

A partir du début des années 80, pour enrayer la détérioration sensible de la position extérieure de l'Union, la BCEAO a mis en œuvre une politique restrictive caractérisée par

un encadrement du crédit qui a permis de contenir l'évolution du crédit et de la position extérieure, au prix d'une allocation administrative des crédits à l'économie et du découragement de la mobilisation des dépôts.

La dégradation de l'environnement économique et financier combiné avec la situation précaire des bilans des banques encadrées a affecté la situation du système bancaire par une forte détérioration du portefeuille des établissements de crédit qui s'est traduite par l'apparition et l'aggravation des soldes débiteurs dans les livres de l'institut d'émission. Pour rétablir les bases d'une intermédiation financière, les autorités monétaires ont mis en œuvre à partir de 1986 un important programme de restructuration du secteur bancaire.

c - A partir de 1989 : Réaménagement des règles de gestion monétaire

Le renforcement des mesures d'ajustement entrepris par les Etats s'est traduit par une libéralisation croissante des économies et la mise en œuvre de réformes structurelles qui ont rendue nécessaire une adaptation des instruments de la politique monétaire et du crédit aux évolutions de l'environnement. Les réflexions menées ont abouti à un réaménagement complet du dispositif de gestion de la monnaie et du crédit. Ce réaménagement vise trois objectifs principaux :

- la réduction du rôle de la monnaie centrale au profit d'une amélioration accrue de l'épargne
- l'abandon progressif des mécanismes administratifs au profit de moyens d'action plus souples et plus incitatifs
- le renforcement de la surveillance bancaire avec la création de la commission bancaire

d - A partir de 1993 : Nouveau dispositif de gestion monétaire

Les directives de la politique de la monnaie et du crédit, redéfinies en octobre 1989, ont induit en 1992, l'entrée en vigueur d'une nouvelle politique monétaire basée sur la libéralisation des conditions de banque. Les axes de cette libéralisation vont dans le sens d'une plus grande initiative laissée aux forces du marché, avec l'utilisation du taux d'intérêt comme principal mécanisme de régulation. Avant cette date, la BCEAO était contrepartie sur le marché monétaire. En plus des taux de réescompte, elle fixait les taux (normal, préférentiel et de pénalité), applicables aux banques.

Avec les réformes de la politique monétaire, des changements structurels ont été initiés, et portent sur l'abandon de l'encadrement du crédit, la suppression des taux préférentiels, la simplification de la structure des taux à travers l'élimination et la consolidation de plusieurs taux d'intérêt et libéralisation des conditions de banque, la délégation de l'autorité de modifier les taux d'escompte au gouverneur de la Banque Centrale.

S'agissant des instruments et mécanismes, la principale réforme a concerné le réaménagement des procédures et la diversification des marchés des titres de la sous-

région. L'adjudication mixte a été remplacée en 1996 par une adjudication adressée aux seuls offreurs et demandeurs dans le cadre d'une politique d'open market. Et, dans le souci d'assurer le libre jeu des forces du marché, les taux uniques ont été remplacés par les taux soumissionnaires. Aussi, de façon implicite, la Banque Centrale pousse-t-elle à une désintermédiation, en offrant la possibilité aux sociétés répondant à certains critères (capital libéré : au minimum 100 millions de francs CFA ; disposer d'un accord de classement à la BC), la possibilité de lever directement des fonds sur le marché monétaire élargi (banques et autres investisseurs institutionnels, certaines entreprises voire même le public).

Le nouveau dispositif se compose donc des trois volet suivants:

- le marché monétaire par adjudication d'enchères régionales
- le système des réserves obligatoires
- le régime des accords de classement

Il a permis de restaurer la liquidité et la solvabilité des établissements de crédit. Toutefois, les concours à l'État sont demeurés à des niveaux élevés du fait de la contraction des recettes fiscales et de la rigidité à la baisse des dépenses courantes. Ce pendant il existe une disposition dans les statuts de la Banque Centrale une disposition qui limite les concours de l'institut d'émission aux trésors publics des Etats membres à 20% des recettes fiscales de l'année précédente. Par ailleurs, les sociétés para publiques peuvent accéder aux financement bancaire dans les mêmes conditions que les entreprises privées. Avant 1993, ces sociétés para publiques ont largement bénéficié des concours du système bancaire, créant ainsi un effet d'éviction au détriment des entreprises privées. Après 1993, avec l'assainissement des finances publiques, la réduction des déficits budgétaires et la privatisation de plusieurs sociétés nationales sous l'égide des partenaires multilatéraux, cet effet d'éviction a décru au profit du secteur privé.

La modification de la parité du franc CFA et la signature du traité instituant l'UEMOA vise à restaurer les conditions d'une croissance durable. Il reste qu'avec l'afflux des ressources extérieures, la situation monétaire est caractérisée par une surliquidité du système bancaire qui coexiste avec des besoins élevés de financement des opérateurs économiques. La BCEAO mène actuellement des réflexions en vue de résorber les excédents actuels de liquidité. Il s'agit en particulier de la titrisation des concours consolidés et du projet de la mise en place de la Bourse de Valeurs Mobilières BRVM. Il est également important que le système bancaire s'engage résolument dans le financement de l'activité économique, notamment dans les secteurs et branches d'activité susceptibles de tirer avantage des décisions de janvier 1994. Le secteur rural qui englobe la majorité de la population pauvre recèle d'importantes opportunités d'investissements. Cependant les coûts de transactions élevés associés à l'intermédiation financière à l'adresse des pauvres

empêchent l'utilisation de ces excédents dans ce milieu. Un meilleur maillage entre le système bancaire et les expériences de finances décentralisées, favorisé par une réforme des infrastructures financières, permettra une utilisation de ces excédents dans le secteur pauvre, plus efficace que celle qu'elle connaît actuellement dans le cadre du marché monétaire.

II - LA LOI BANCAIRE

A - ELEMENTS DESCRIPTIFS

La loi 90.06 du 26 juin 1990, portant réglementation bancaire s'applique aux banques et établissements financiers installés sur le territoire sénégalais, hors BCEAO et institutions internationales ou de coopération.

La banque est définie dans le cadre de la loi, comme toute entreprise qui reçoit à titre de profession habituelle, des fonds qu'elle emploie pour son propre compte ou pour le compte d'autrui, en opérant des crédits ou des placements. Alors que les établissements financiers effectuent des opérations de crédit, de vente à crédit ou de change, et/ou reçoivent des fonds qu'elles emploient en opérations de placements.

Pour bénéficier d'un tel statut juridique, la banque ou l'établissement financier doit au préalable, être agréé par le Ministère de l'économie des finances et du plan (MEFP) sur instruction de la Banque Centrale et après avis de la Commission Bancaire. La loi exige que les banques aient la forme de société et que les établissements financiers soient des sociétés anonymes. Il existe cependant certaines dérogations pour les banques ou établissements financiers à statut spécial, les banques islamiques et les institutions mutualistes ou corporatives. Pour ces dernières, l'article 20 autorise leur création par autorisation spéciale du Ministre des Finances, donnée après avis de la commission bancaire. La loi établit par ailleurs l'interdiction pour les établissements non agréés d'utiliser les termes " banque" ou "établissement financier", avec une dérogation pour les bureaux de représentation d'établissements dont le siège social est à l'étranger, sous réserve d'information de la Banque Centrale sur ces bureaux.

B- DISPOSITIFS PRUDENTIELS

Globalement, le nouveau dispositif prudentiel fixe les normes de gestion applicables aux banques et établissements financiers et se rapporte aux domaines suivants :

1- Les conditions d'exercice de la profession

Le capital social exigé pour la création d'une banque est au minimum de 1 milliard de francs cfa (US$ 1,5 à 2 millions), contre 300 millions (US$ 0,6 millions) de francs cfa pour un établissement financier et les fonds propres doivent au minimum être égaux au capital minimum ainsi fixé. Outre la réserve légale, une réserve spéciale est devenue obligatoire pour renforcer les fonds propres.

2- Les réglementations comptables

Il est fait mention obligatoire aux banques et établissements financiers de produire des documents financiers de fin d'exercice à la BCEAO qui devra publier leur bilan annuel dans le journal officiel. Il a aussi été défini l'organisation de la certification des comptes, la définition des fonds propres effectifs et les règles minimales de provisionnement des risques en souffrance au niveau des impayés et créances immobilisées, des créances douteuses et litigieuses, des créances irrécouvrables.

3- La réglementation des opérations effectuées par les établissements de crédit

La participation directe ou indirecte dans une entreprise ne doit pas être supérieure à 25% du capital de cette dernière ou à 15% des fonds propres effectifs de l'institution. Les prêts aux principaux actionnaires, dirigeants et au personnel des institutions de crédit ne peuvent excéder 20% des fonds propres effectifs et la commission bancaire doit être informée de tout concours qui leur serait octroyé et dont l'encours pour une seule personne atteindrait 5% des fonds propres effectifs de l'établissement. En outre, les immobilisations hors exploitation, ne peuvent dépasser le seuil de 15%. Le total des immobilisations et des participations ne doit pas, en cumul dépasser 100% du fonds propre des institutions.

4- Les normes de gestion

La loi bancaire a édicté 5 ratios que les établissements de crédit sont tenus de respecter et qui font l'objet d'un suivi attentif de la Commission Bancaire.

- La couverture des risques :

Le taux est provisoirement fixé à un minimum de 4%, mais devra progressivement tendre vers la norme internationale. Il se détermine à partir du rapport Fonds propres effectifs/ risques nets.

▪ Le coefficient de couverture des emplois à moyen et long terme par des ressources stables :

Ce ratio vise à éviter à ce que les banques ne fassent de la transformation excessive des ressources à vue ou à court terme en emploi à moyen ou long terme, obligeant ainsi ces dernières à financer par des ressources stables non seulement leurs actifs immobilisés en totalité, mais aussi une certaine proportion de leurs autres emplois à moyen ou long terme. Sa base de calcul est : emploi à moyen et long terme/ressources stables = 75%.

A préciser que pour l'heure, bon nombre d'établissements ne pouvant répondre à cette exigence, son application est provisoirement différée.

▪ Le ratio de liquidité :

La norme à respecter est fixée provisoirement à 60%. Il se calcule par le rapport entre les actifs disponibles et réalisables ou mobilisables à court terme/ le passif exigible à court terme et engagement à court terme.

▪ Le ratio de division des risques :

Pour une seule et même signature, le montant total des risques ne peut être supérieur à 100% des fonds propres effectifs d'une banque ou d'un établissement financier. Pour des signatures atteignant 25% des fonds effectifs, elles ne peuvent ensemble dépasser 10 fois ces dernières. Au numérateur, on trouve les fonds propres effectifs. Au dénominateur sont repris les risques au bilan, y compris les titres détenus et les engagements hors bilan. A noter que sont exclus les risques relevés : les crédits de campagne et les crédits garantis par nantissement de marchés publics.

▪ Le ratio de division du portefeuille :

C'est un ratio qui constitue, dans le cadre des accords de classement, un moyen de mettre l'accent sur la qualité des financements bancaires. Il se calcule par le rapport entre, d'une part, l'encours des crédits bénéficiant des accords de classement délivrés par la BCEAO à la banque qui présente le dossier et, d'autre part, le total des crédits bruts portés par l'établissement concerné.

III - DE LA LOI BANCAIRE A LA LOI PARMEC

La nouvelle loi cadre bancaire a été élaborée dans un contexte difficile, où la situation précaire du système financier imposait un maximum de rigueur dans la conception des instruments de gestion des banques et établissements financiers. Cette situation n'a pas fait perdre de vue la réalité financière organisationnelle de plusieurs entités de base, en faveur desquelles il a été opéré une relative ouverture.

A - ELEMENTS DESCRIPTIFS

Les établissements constitués sous forme de mutuelles ou coopératives d'épargne et de crédit ont la possibilité de solliciter le statut de banque, lorsque les conditions requises à cet effet sont par ailleurs remplies, et avoir, sur autorisation du Ministre des Finances, la forme juridique de société à capital variable. Une seconde ouverture introduite par la loi est relative à certaines dérogations et assouplissements dans l'application des règles prudentielles (art 44, alinéa 3). La réforme bancaire reconnaît explicitement, la nécessité d'un cadre flexible pour ces institutions, qui ne sont pas assujetties à la réglementation bancaire. Mais dans la mesure où ce stade intermédiaire concerne une grande diversité de structures de base, il est apparu judicieux d'envisager un cadre juridique adaptable à la situation et aux règles de fonctionnement de ces expériences. De là découle la loi PARMEC qui à son tour va opérer une autre ouverture sur les groupements et autres systèmes financiers non mutualistes. Ce cadre juridique a été adopté au Sénégal avec l'avènement de la loi 95.03 du 05 mars 1995 et de son décret d'application.

B- DISPOSITIF REGLEMENTAIRE ET CONVENTIONNEL

La loi et le décret d'application fixent un certain nombre de règles que les institutions sont tenues de respecter. Ce nouveau texte poursuit 3 objectifs, à savoir : assurer la sécurité des opérations financières ; assurer la protection des déposants ; assurer l'autonomie financière des institutions. Il est complété par une convention cadre adoptée par le conseil des Ministres de l'UEMOA le 04 juin 1996 à Dakar.

La loi en tant que telle, s'applique indistinctement aux institutions mutualistes d'épargne et de crédit qu'aux institutions faîtières (unions, fédérations, confédérations), mais elle a aussi aménagé une ouverture aux groupements d'épargne et de crédit qui, bien que ne bénéficiant pas de la personnalité morale, peuvent être reconnus par décision du Ministre des Finances. La convention cadre, quant à elle, concerne les structures ou organisations non mutualistes qui exercent des activités d'épargne et de crédit. Il s'agit généralement d'organisations non gouvernementales ou de projets qui sont impliqués dans des actions de développement à la base. Elle détermine entre autres les conditions d'exercice des activités autorisées ; les modalités de reconnaissance ; les règles de fonctionnement ainsi que les modalités de contrôle.

Nous sommes ainsi en présence de 3 catégories d'institutions ou structures :

- Les institutions mutualistes d'épargne et de crédit bénéficiant d'un agrément ;
- Les groupements d'épargne et de crédit bénéficiant de la reconnaissance ;
- Les autres structures ou organisations bénéficiant d'une option entre la loi bancaire ou une convention avec le Ministère de Finances.

Les avantages accordés par la loi sont divers et multiples. On peut citer entre autres la légalisation des activités, la personnalité morale, la protection de la dénomination sociale, l'exonération fiscale, les recours des décisions du Ministre, l'exception au régime d'affiliation ...

Dans le cadre du suivi des institutions, la loi confère la tutelle au Ministre des Finances. Ainsi, celui ci dispose de pouvoirs très étendus dans les domaines d'octroi ou de retrait d'agrément ou de reconnaissance, de sanction disciplinaire et de poursuites pénales, d'inspection ou de contrôle, de dérogation aux règles financières.... Il doit par ailleurs être informé dans les cas de modification de statut, de dissolution volontaire, des états financiers et rapports annuels, déclaration pour agrément d'office... Cette tutelle est complétée par l'intervention de la Banque Centrale et de la Commission Bancaire qui apportent leur concours en matière de normes de gestion et de contrôle.

La loi et le décret d'application fixent trois (3) catégories de règles que les institutions de base ou faîtières, sont tenues de respecter.

- Les premières règles concernent la politique de crédit des institutions :

C'est l'assemblée générale "qui définit la politique de crédit", mais, est tenue, pour ce qui concerne le taux d'intérêt, de respecter les plafonds fixés par la loi sur l'usure.

- D'autres règles concernent la limitation des risques :

Le total des risques porté par une institution ne doit pas dépasser le double des dépôts de ses adhérents. Aussi, le plafond du crédit que l'institution peut accorder à un membre ne peut dépasser 10% de l'ensemble des dépôts qu'elle a reçus. Enfin, les prêts accordés aux membres de ses conseils ou à son gérant ne peuvent excéder 20% du total de ses dépôts.

- D'autres règles enfin concernent des aspects particuliers de l'activité d'une institution: contrairement aux banques, ces institutions ne peuvent pas faire de transformation. Leurs ressources stables doivent, en permanence, excéder les emplois à moyen et long terme. De plus, les valeurs disponibles réalisables et mobilisables à court terme doivent représenter en permanence 80% du passif exigible et des engagements à court terme.

Les institutions peuvent créer des sociétés de services en vue de satisfaire les besoins de leurs membres. Mais les fonds engagés ne peuvent dépasser 5% des risques de l'institution, sauf autorisation du Ministre des Finances.

Par ailleurs, la loi prévoit que la rémunération des parts sociales doit être limitée et rend obligatoire la constitution de réserves générales. Le décret précise que 15% des excédents, avant ristourne, doivent être affectés à la réserve. Il appartient au statut de chaque institution de fixer la ristourne ou le dividende versé aux adhérents.

CHAPITRE III - LE RESEAU FINANCIER DES DEMUNIS

I - L'OFFRE FINANCIERE DECENTRALISEE

L'avènement des systèmes ou structures mutualistes de financement décentralisés (SFD) au Sénégal date du milieu des années 1980 et s'est traduit par une floraison de caisses d'épargne et de crédit existant à coté d'organisations financières traditionnelles. A la base de ce phénomène, il y a plusieurs facteurs externes et internes qui tiennent d'abord au phénomène de mode qui a traversé le financement du développement à cette époque, faisant de la mise en place de systèmes d'épargne et de crédit un projet intéressant aux yeux des bailleurs de fonds et organismes de coopération. Ils tiennent ensuite au rôle prépondérant qu'a joué le Ministère des Finances dans la formation et la sensibilisation à l'idée de caisses mutuelles d'épargne et de crédit.

Aussi dans le cadre d'une étude, "diagnostic du financement du monde rural", réalisée en 1996, la mission a pu identifier près de 91 promoteurs de SFD ayant suscité la création de 363 entités de base pratiquant des activités d'épargne et de crédit (hors groupements féminins). Ces institutions de financement décentralisé regroupent une variété d'expériences de crédit et/ou d'épargne et se différencient par les moyens techniques, humains, financiers mis en œuvre ; par les objectifs, la philosophie, la taille ainsi que le niveau de structuration.

Les structures d'épargne et de crédit (mutuelles) et les systèmes de financement non mutualistes ou coopératifs sont les principaux types d'institutions de micro financement au Sénégal.

A - LES EXPERIENCES D'EPARGNE/CREDIT MUTUALISTE

Ces expériences reposent sur les principes de la mutualité ou coopérative qui veut qu'elles soient des groupements de personnes sans but lucratif, guidés par des liens de solidarité et d'entraide. Qu'elles soient ou non, dotées de la personnalité morale, leur mise en place répond globalement au souci de fournir des services financiers de proximité, réservés à leurs membres. La primauté de la mobilisation de l'épargne est le principe de base de ces institutions. L'épargne y a généralement autant d'importance que le crédit qui est octroyé traditionnellement aux membres tant pour des besoins de consommation que pour des besoins de production. Le système de sécurité lié aux prêts repose le plus souvent sur la solidarité du groupe.

Selon le degré de complexité de leur gestion, nous pouvons distinguer les systèmes à épargne libre des systèmes à cotisation.

Les systèmes à épargne libre

Ils prennent généralement la forme de caisses mutualistes d'épargne/crédit et tombent sous la coupole de la loi 95-03. Là encore, elles peuvent être classées en deux grands groupes:

- Les réseaux fortement appuyés par les bailleurs de fonds.

61 institutions, à travers le pays, ont été recensées dans le cadre de la mission sus citée. Les plus importantes en terme de volume de crédit et d'échelle des opérations sont, le Crédit Mutuel sénégalais (CMS), l'Alliance de Crédit et d'Epargne pour la Production (ACEP), le Programme d'Appui aux Mutuelles d'Epargne et de Crédit au Sénégal (PAMECAS).

Dans l'approche, elles s'adressent dans certains cas à une clientèle particulière, (ACEP pour les micros activités), exigent des garanties mobilisables et offrent une bonne sécurisation de l'épargne. Ils sont globalement très efficaces du point de vue de la gestion ; largement implantés ; dominés par les salariés ; faiblement implantés dans les villages.

- Les réseaux nés d'initiatives locales avec de faibles appuis externes se caractérisent, le plus souvent par une absence généralisée de comptabilité fiable ; une très faible sécurisation de l'épargne ; une forte implantation dans les villages et un faible soutien technique et financier. Ce sont notamment les caisses de CRECIS dans le Balantacounda[3],

Au moment de l'étude, très peu de réseaux des deux catégories avaient demandé et obtenu l'agrément de leurs caisses. Mais la tendance actuelle serait à l'inverse, si l'on en croit les données du Ministère des Finances.

Pour l'essentiel de ces institutions, les taux d'intérêt débiteurs varient entre 13 et 24%, et ne font aucunement référence au taux d'usure défini par les Autorités monétaires. La rémunération de l'épargne quant à elle, varie entre 4 et 6%.

Pour des raisons évidentes, liées à la taille (en terme de nombre d'adhérents), et l'incompétence managériale des dirigeants, le différentiel de taux ne permet que dans de très rares cas, une autonomie financière des institutions. Nous pouvons également citer la législation restrictive en terme de taux de transformation et de ratio de liquidité combinés à la limitation des ressources des structures financières.

La plupart de ces institutions, bien qu'offrant des services financiers à un nombre important d'adhérents, ne répondent pas aux besoins des plus démunis, en ce sens qu'elles ne sont pas accessibles à tous.

[3] région naturelle au sud de Sénégal à cheval sur les région administratives de Ziguinchor, Kolda et sur le nord de la Guinée Bissao.

Les systèmes à cotisations

Ces systèmes sont particulièrement répandus dans les campagnes sénégalaises et concernent une population particulièrement importante. Généralement ; ils se caractérisent par un développement très ancien ; un mouvement courtisé par les bailleurs de fonds ; des coûts de crédit élevés mais qui profitent à la structure et à ses membres ; une utilisation de fonds à destinations multiples ; une forte appropriation par les membres ; des ressources insuffisantes relativement aux besoins de financement exprimés et un volume de financement effectif faible.

Au-delà des caractéristiques générales, ce sont des systèmes souples, pour lesquels, la mise en œuvre ne nécessite pas un système de contrôle et de gestion, très sophistiqué, dans la mesure où tous cotisent de la même façon. Ils ne fonctionnent pas tous de la même façon, et bien des fois, certains complètent les cotisations par des travaux collectifs de types élevage ou champêtre. Les rythmes de cotisation varient mensuellement, et leur niveau peut aller de 50 F à 1.000 F, voire plus.

Ces systèmes n'assurent pas la liquidité des fonds et ne sont pas ouverts au point d'assurer des services aux non-membres. Cependant, ils comblent des créneaux importants comme l'opportunité offerte aux membres de se constituer une épargne sure suscitant une capacité d'endettement.

B - LES SYSTEMES NON MUTUALISTES OU COOPERATIFS

Les Projets et ONG de développement qui sont les entités composantes de ces systèmes, ne peuvent pas légalement mobiliser des dépôts et ont généralement comme principal objectif, l'octroi de prêts productifs à une clientèle ciblée. L'épargne joue, dans ces expériences, un rôle de produit de remplacement ou de service parallèle. Selon que l'activité est principalement ou accessoirement basée sur le crédit, on peut distinguer les expériences de crédit direct et les projets à volet crédit.

Les expériences de Crédit Direct

Le système de Crédit direct privilégie le rôle central du crédit qui pourrait, dans sa mise en œuvre, générer des disponibilités d'épargne. L'accent est surtout mis sur la satisfaction des emprunteurs visés par le projet et, la performance est mesurée en fonction du nombre de prêts accordés, les changements intervenus en terme d'emplois, de revenus.... Le problème du recouvrement des prêts, les coûts élevés de l'intermédiation sont, dans ce contexte, considérés comme accessoires au regard de l'optique visé. La viabilité de l'activité des bénéficiaires et la bonne santé financière du système sont donc, ici, relégués au second plan.

Les institutions intervenant dans ce système sont le fruit de la coopération entre l'État Sénégalais et ses partenaires qui interviennent dans le cadre de projets ou à travers des ONG; ceux sont:

- Conseil et Partenariat Entreprise - COPARE - à Saint Louis;
- Association Nationale des Maisons Familiales Rurales à Thiès;
- le Fonds de Contrepartie Sénégalo-Suisse ;
- Projet PME / Thiès.
- Projet d'Appui au Développement des PME à Dakar;

Les projets à volet crédit

Le crédit dans ces expériences est une mesure d'accompagnement d'une activité principale à l'origine du projet. Dans leur fonctionnement, ces systèmes de crédit s'inspirent de la dernière expérience citée ci-dessus. Globalement, les partisans de ce type d'expérience accordent une grande importance et partent du principe selon lequel "c'est le crédit qui fait l'épargne".

Certaines de ces expériences, dans l'optique d'une plus grande pérennisation, tentent de capitaliser leurs expériences en créant leurs propres réseaux (les caisses de FDEA) ou développent des partenariats avec des systèmes existants (ce qui est typique au cas de PMR et CMS au profit des Groupements Féminins de Thiès) ou avec les Banques (PAPEC/CNCAS pour le développement de la pêche artisanale ou encore PAPEL/CNCAS pour la promotion de l'élevage).

Ces différents systèmes ont des objectifs, des groupes cibles, des modes d'organisation et de fonctionnement, des conditions financières et des volumes d'intervention assez divers et définis en fonction des préoccupations du bailleur ou du partenaire. Mais toutes ont des objectifs de développement (améliorer les conditions de vie des groupes cibles, promouvoir des activités génératrices de revenus), des objectifs d'Education/Formation (qui sont davantage des objectifs dérivés ou indirects pour certains systèmes) et cherchent à offrir des produits financiers (mobilisation de ressources et/ou distribution de crédits) aux plus démunis, exclus du système bancaire classique.

Les limites liées à ces différentes expériences tiennent, entre autres, au fait qu'elles s'appuient très fortement sur des subventions qui, globalement, s'appliquent tant aux charges de fonctionnement qu'aux taux d'intérêt appliqués sur les prêts. Le ciblage des prêts en vigueur dans ces différents systèmes a aussi l'inconvénient de nuire à la bonne santé du marché réel, et ne favorise pas une intermédiation de qualité, viable et accessible aux populations les plus pauvres.

C- L'OFFRE FINANCIERE INFORMELLE

Les pratiques de financement informel ont toujours existé en Afrique. On les retrouve à travers les systèmes d'entraide et de solidarité financière qui se sont le plus singularisées à travers les tontines empruntant des formes diverses telles le "ndawtal", le "nate", le "fôte" au Sénégal, le "diagokoun" et le " manankoun" au Mali. Elles émanent également d'initiatives privées attirée par la possibilité de réaliser des marges substantielle au prix d'un risque maîtrisé grâce aux liens sociaux et/ou aux gages parfois exigés les prêteurs sur gages. Ces systèmes se sont construits, à partir des valeurs traditionnelles et s'appuient sur la mobilisation d'épargne pour la couverture des besoins sociaux et économiques. Cette dernière forme d'offre financière informelle inclut aussi les gardes-argent et le crédit fournisseur (qui n'est pas du seul apanage de la finance formelle).

II - MODE DE FINANCEMENT ET COMPORTEMENT FINANCIER DES PLUS DEMUNIS

A - MODE DE FINANCEMENT DES DEMUNIS

Une enquête réalisée dans le cadre de SOAP montre que les besoins exprimés par les pauvres en termes de priorités s'orientent 1°) vers la génération de revenus, 2°) vers la constitution d'une épargne sure, liquide et bien rémunérée, 3°) des possibilités de transferts rapides, fiables, et peu chers, 4°) augmentation de la capacité d'endettement.
Au Sénégal, l'amplification du phénomène micro finance est en forte corrélation avec le développement d'un secteur informel urbain et rural qui a été la réponse à la pauvreté, résultant du décalage entre la croissance accélérée de la population et la détérioration de la situation économique ayant induit une rigueur budgétaire au détriment des questions sociales. Telle que formulée dans cet univers des démunis, la finance informelle s'opère dans un cadre informel, organisé et contrôlé par le secteur informel.

Aussi, tous les produits et services financiers du secteur moderne, ont leurs correspondants dans le secteur informel. Cela va du change au crédit, de l'épargne au transfert.
En matière de financement des activités productives, les sources sont diverses et variées. L'entrée en activité s'opère le plus souvent à partir d'économies réalisées dans une occupation de type salariale ou encore par le canal de parents ou d'amis qui, gracieusement ou contre remboursement, mettent à la disposition du nouvel opérateur les modestes moyens techniques ou financiers. La capacité à fructifier ces faibles moyens de départ est

souvent gage d'une bonne maîtrise d'un métier dont la consolidation pourrait nécessiter l'appel à un financement additionnel. Le crédit dans cet univers de la pauvreté joue le rôle de la "cinquième roue du carrosse", et n'y constitue en rien, comme bien des gens l'on déjà pensé, la condition impérieuse de la création de revenu. Tout au plus, s'il est mal pensé, il peut engendrer des effets dommageables dans le système. Le crédit dans le système traditionnel provient de sources diverses, à des conditions diverses. Il émane de parents, d'amis, de garde-argent, de commerçants, de tontine....Il peut être gratuit, comme il peut être conditionné à des intérêts plus ou moins exorbitants. Un cas extrême a été identifié à Dagana, dénommé "thieub-thieub", qui porte sur des prêts journaliers rémunérés entre 40 et 50%[4] par jour. Ce taux, hors norme et qui paraît inimaginable de notre point de vue, est pourtant accepté par les contractants qui, dans les transactions de changes (CFA/ OUGUIYA[5]) réalisent des marges substantielles. La même pratique est observée sur tous les marchés urbains, où des femmes empruntent dans les mêmes conditions pour effectuer des transactions permettant un différentiel d'intérêt rémunérateur.

Pour ce qui est du domaine des transferts, ils s'opèrent dans le milieu des pauvres par le canal de transporteurs, voyageurs ou commerçants. Sa sécurité est le plus souvent basée sur la solidarité et les liens sociaux existants entre les sous-groupes. Ce système est bien connu des sénégalais, et revêt une dimension internationale à travers la "banque de Sandaga[6]" qui, en sus, offre le service de change, souvent dans des conditions plus rapides et plus avantageuses que les banques classiques. Aussi, nous n'avions pas été surpris lorsqu'un éminent banquier de la place nous a avoué que *" en cas de voyage urgent et non prévu, je fais mon change au marché Sandaga"*. Ni même lorsque le Ministre des finances, interpellé sur la question lors d'un séminaire, répondait *"... je suis né et j'ai trouvé la pratique bancaire à Sandaga. Ce n'est pas avec moi que cela va disparaître..."*
Pour les 363 entités de base identifiées dans le cadre de l'étude "diagnostic du financement du monde rural au Sénégal ", en 1996, le montant global de l'épargne collectée sur une durée moyenne de 5 ans, se portait à 9,54 milliards de francs CFA (US$ 14 - 15 millions). En rapport avec le nombre de sociétaires recensés (79.590), la moyenne de l'épargne annuelle, pour les populations pauvres rurales, tourne autour de 23.000 F (US$ 35 - 40). "L'épargne existe chez les démunis". Et pour beaucoup, elle constitue la condition de survie en période de "vache maigre". L'épargne des pauvres est plus élevée que l'on peut bien le penser. Le Sénégal connaît ses modalités propres d'épargne. Elle revêt la forme d'épargne coutumière (cheptel, bijoux ...), d'épargne travail (corvées familiales ou villageoises), d'épargne céréales (greniers familiaux ou magasins des groupements), d'épargne familiale thésaurisée (monétaire), d'épargne tontinière.

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[4] cela ne s'exprimant pas en année
[5] unité de compte monétaire de la Mauritanie.
[6] Il s'agit de pratiques financières ayant lieu au principal marché de Dakar (Sandaga)

La finance traditionnelle a l'avantage de cadrer avec les réalités et les besoins des populations pauvres. Mais sous toutes ses formes, elle présente des insuffisances et obéit à des règles qui ne permettent pas son grand développement.

B - COMPORTEMENT FINANCIER DES DEMUNIS

Pour une plus grande compréhension des us et coutumes financières des démunis, l'option va porter ici sur une série d'exposés de cas.

Cas 1 - Dieynaba LY

Djénaba LY a 52 ans. Elle est la première des quatre épouses d'un homme de 70 ans qui, du fait de problèmes de vue mais aussi de par son âge avancé, est désormais inapte au travail. Elle est mère de 7 enfants et a en charge 3 petits-fils qui vivent avec elle dans la concession familiale située au village de Pendao. De par sa position de première épouse, c'est à elle que revient en priorité la charge de la satisfaction des besoins primaires de la famille, comme elle nous l'a fait savoir au cours de l'entretien présenté ci-après.

Activité

« Je partage un champs collectif d'une superficie de 1 hectare avec 99 autres femmes du village (chaque femme a droit à une superficie d'un are); j'y cultive du riz.
A coté de cette activité, je fais du maraîchage en contre saison sur un jardin familial, que j'exploite avec mes co-épouses. Et, comme toutes les femmes en saison sèche, je fais du petit commerce de produits de premières nécessités.

Revenus

Ce sont les produits de mes activités agricoles, de petit commerce, et l'argent que m'envoient mes enfants. Les revenus de l'agriculture ne suffisent pas à couvrir les besoins de la famille, nous avons tout juste de quoi manger pendant quelques temps. C'est surtout l'argent que les enfants envoient qui me permet de faire le petit commerce et disposer d'un peu de liquidité durant la saison sèche.

Financement

Avant, en début de campagne agricole, nous prenions de l'argent dans notre tontine et les services d'encadrement nous donnaient les intrants en crédit. Pour les autres activités, j'utilisais mes propres moyens qui proviennent essentiellement de l'argent que mes enfants m'envoient de temps à autre. C'est surtout cet argent que j'utilise pour faire du commerce.
Depuis quelques temps, cette situation a changé car nous disposons dans le village d'une caisse d'épargne et de crédit. La caisse nous prête de l'argent pour acheter les intrants à

des conditions plus avantageuses et moins lourdes. En plus, nous pouvons emprunter pour financer d'autres activités en dehors de l'agriculture.
Avant la création de la caisse, je n'avais d'autres alternatives que le crédit de campagne ou les envois de mes enfants. Sinon j'avais souvent recours au service de Djiby, un commerçant ami de mon frère, installé au village. Djiby m'avançait des marchandises que je revendais dans les marchés des villages environnants.

Transfert

A chaque fois que je me lève le matin, je prie le bon dieu pour qu'il veille davantage sur mes enfants qui me sont d'un soutien inestimable. Je comprends que c'est difficile là où ils sont. Mais cela ne les empêche pas de nous venir en aide régulièrement. Au début, ils envoyaient des mandats par le canal du bureau de poste de Podor ou par des voyageurs ou transporteurs. Par la suite, ils s'arrangent avec leur ami Djiby qui me donne de l'argent ou de la marchandise.

Epargne

Je n'ai pas d'argent à épargner, car je n'en gagne pas suffisamment. Comme tu vois, nous avons ce grenier où nous stockons des céréales en prévision des périodes de soudure. A chaque fois que je reçois de l'argent des enfants, je m'arrange pour acheter une brebis ou une chèvre que j'élève dans l'enceinte de la maison. Avec la caisse, nous sommes obligés d'épargner souvent pour prétendre au crédit. Mais, bien avant, avons mis en place une tontine. Dans notre système d'organisation, chaque femme cotise 500 F par mois. A chaque tirage, c'est juste la moitié des cotisations qui est versée à la personne qui gagne le tour. Le reste de l'argent est maintenu dans la caisse commune et devra servir dans les cas d'urgence et au financement de la campagne agricole.

Priorités

Dans le contexte où nous évoluons, nous avons plutôt besoin que l'on nous aide dans l'écoulement de notre production. Après toute une campagne de dure labeur, nous avons beaucoup de difficulté pour vendre notre récolte à un prix convenable. Les structures d'encadrement qui sont là ne nous appuient que dans le domaine du crédit. Mais à quoi sert le crédit si les revenus tirés de l'activité ne nous permettent pas de rembourser.
Nous sommes des femmes, et nous n'avons pas de moyens, mais nous avons la volonté et le courage nécessaire pour travailler et subvenir au besoin de la famille.

Cas 2 - Mbathio NIANG

Mbathio NIANG est une femme habitant à Thiaroye/mer. Elle a 50 ans, son mari est à la retraite, elle a 5 enfants mineurs et a en 5 autres en charge.

Issue de parents pauvres, elle n'a pas été à l'école et est rentrée dans la vie active à l'âge de 15 ans, aidant sa belle-mère dans la transformation de poissons dans la baie de Thiaroye.

Activité

Pendant 7 ans elle a été écailleuse, laveuse, sécheuse, vendeuse etc. Durant les 2 premières années, elle s'est réservée exclusivement à sa belle-mère. Par la suite, en plus de l'assistance gratuite portée à sa belle-mère, elle a commencé à vendre ses services aux autres bonnes femmes transformatrices installées sur la zone. Ainsi elle arrivait à se faire des revenus variant entre 500 et 1000 francs suivant l'ampleur de l'activité. L'argent qu'elle gagnait, elle l'utilisait en partie pour les besoins primaires de sa famille.

Elle a toujours su ce qu'elle voulait, comme elle aime le dire. Aussi, pendant tout ce temps, confiait-elle l'autre partie de ses revenus à son oncle, ami et confident.

Mbathio a particulièrement été choquée le jour où, après 3 ans d'économie, son oncle lui a soutenu qu'elle ne lui a jamais confié de l'argent. Non seulement elle a été déçue mais sa belle-mère lui en a voulu de ne lui avoir pas fait confiance à elle.

Par la suite, conformément aux recommandations de cette dernière, c'est vers elle qu'elle s'est tournée pour capitaliser ses économies.

Au bout de la septième année "d'apprentissage", la belle-mère s'est retirée de l'activité, en cédant à Mbathio le matériel d'exploitation rudimentaire qu'elle possédait et en lui rendant toute l'épargne (70.000 francs) qu'elle l'avait confiée.

Financement[7]

Ainsi pour tout dire, Mbathio a repris une affaire et a financé l'exploitation par son épargne. Dans son lieu d'exploitation, il a de tout temps existé un groupement (PENTHIOUM SENEGAL) qui lie toutes les femmes (200) travaillant dans la profession et exerçant sur la plage. Des liens de solidarité et d'entraide ont toujours été le fondement du groupement. *"On nous avait proposé un financement que certaines d'entre nous ont accepté, mais d'autres ont refusé, car ne connaissant pas ce qui a motivé cette décision du bailleur. C'est de là que découle la première scission de Penthioum Sénégal en deux sous groupements : le nôtre BOKK DIOM qui a accepté et FEKH BEUGUE DIAM. Le prêt a été totalement remboursé."*

Aujourd'hui, PENTHIOUM SENEGAL se compose de 12 sous-groupes dont celui de Mbathio qui compte 17 membres. Le groupement est appuyé par FDEA, ADPES, et FENAGIE, qui interviennent dans le domaine du crédit direct et dans la formation, mais aussi par PROPECHE uniquement dans le domaine du financement.

[7] US$ 1 = 550 CFA

"Par le passé, nous avons travaillé avec le PAPEC pour un crédit de 2.125.000F, les conditions étaient très difficiles. Pour 5.000 F empruntés, on rembourse 5.500F. On a eu 125.000F chacune et on remboursait 33.000F pendant 5 mois. Nous allons jusqu'à la banque à Dakar pour payer et pour des raisons de sécurité, nous étions obligés de prendre le taxi qui nous coûte 1.500F. Par la suite la banque nous a proposés de payer à YARAKH ce qui nous coûtait 800 francs de taxi chaque mois."
"Nous avons aussi bénéficié d'un financement ADPES chacune d'entre nous a eu 50.000 F que nous avons payé sur une durée de 15 mois en bénéficiant d'un différé de 4 mois mais nous avons préféré payer dès le 2ème mois. A la fin ADPES a ristourné à notre groupement 600.000 F. Avec ADPES, à chaque fois qu'il a fallu payer, nous les faisons appeler pour qu'ils viennent récupérer le remboursement. Nous avons aussi bénéficié d'un financement de 578.000 F de la FDEA, chacune de nous a reçu 30.000 F que nous avons remboursé intégralement presque dans les mêmes conditions que ADPES."

"Aujourd'hui beaucoup de projets nous côtoient et nous proposent du crédit. Nous n'en voulons pas tout temps. Mais compte tenu des relations que nous avons avec les uns et les autres, notamment avec ADPES et FDEA, nous ne voulons pas les décevoir. Et c'est d'ailleurs pour ça que nous ne touchons pas à notre argent dans notre compte à la FDEA."
Et à une collègue de Mbathio de rajouter : *"Nous avons peur du crédit ; nous ne pouvons pas rembourser tout le temps."*

Epargne
Dans ce domaine, Mbathio a été "échaudée et craint l'eau froide". Depuis l'incident avec son oncle, elle est particulièrement attentive à la sécurité de l'argent. Elle participe à 2 tontines respectivement dans son cadre de travail, et dans son quartier. Dans la première tontine, elle est trésorière. Elles sont 100 femmes à cotiser 200F par jour avec tirage tous les 5 jours. Ce qui permet une levée de 100.000F pour chaque personne qui gagne le tour. Dans son quartier où la tontine porte sur de l'équipement domestique, des habits et bijoux, elles sont 40 et cotisent 1000 F par mois, avec un tirage à chaque fin de mois.
Mbathio est mariée à un homme de 57 ans, au chômage depuis plus d'une dizaine d'années. *"Pour occuper mon mari, mais aussi pour éviter qu'il pense à me trouver une co-épouse, j'ai acheté des moutons et je lui en ai confié la garde. C'est là aussi une autre façon de sécuriser mon argent."*
BOKK DIOM, le groupement de Mbatio, dispose d'un compte d'épargne à la FDEA, et à la CNCAS.

Priorité
"Grâce à Dieu, nous évoluons dans un secteur d'activité où les choses vont mieux que dans bien d'autres. Mais, si aujourd'hui, nous arrivons à écouler nos produits, les prix que

les commerçants et les revendeurs nous proposent ne sont pas toujours intéressants. Si aujourd'hui vous voulez nous aider, alors aidez-nous à trouver des marchés plus intéressants. Dans le traitement du poisson, il nous arrive aussi de nous blesser au point de devoir aller à l'hôpital. A chaque fois, on nous fait payer très cher, alors que pour les fonctionnaires, c'est moins cher. Aidez-nous aussi à avoir les mêmes avantages que ces derniers."

Cas 3 - M. Seydou NDIAYE

Quand il avait 15 ans, son père lui donna 4 moutons qu'il vendit. Il utilisa l'argent collecté pour payer un voyage vers le Burkina Faso où des parents lui prêteront une somme de 45.000 francs (US$ 180, à l'époque) avec laquelle il se procure un stock de lunettes et devient marchand. Deux années après, il rembourse l'argent et revient à Podor. Avec l'argent qu'il a gagné et épargné pendant son activité, il se construit une maison. Il reste 6 mois et entreprend un autre voyage vers la Côte d'Ivoire où il vendra aussi des lunettes. A Abidjan comme à Ouagadougou, il achète des produits chez un grossiste et vend au public. Il place son épargne dans une banque formelle.

En 1990, il retourne au Sénégal définitivement. Il s'installe en tant que commerçant et vend des produits alimentaires. Il pense que c'est une bonne idée d'être revenue chez lui, il est avec sa famille et est en mesure d'obtenir un crédit et de l'assistance de la part des grossistes qui connaissent ses parents et lui font confiance. Il cultive du mil pour la nourriture de sa famille et tient une petite boutique dans sa maison. Tous les dimanches, il va vendre au marché régional de DODDEL.

Seydou NDIAYE achète tout ce qu'il vend à Hamid DIOP qui lui permet de tenir son stock sans payer les frais. Sur ses revenus, il lui rembourse son prêt chaque semaine ou chaque quinzaine. Il n'y a pas eu d'intérêt sur ce crédit.

Seydou NDIAYE ne dispose de rien dans les comptes en banque qu'il a ouvert et gardé à l'étranger. Il a aussi un compte à la CBAO mais il tient tout son argent en espèces.

Il bénéficie d'un crédit en marchandises chez M. DIOP qu'il replace auprès de ses clients et est payé toutes les semaines. Cette facilité de paiement lui permet de conserver sa clientèle dit-il.

Il aide également les membres de sa famille qui sont dans le besoin. Il leur a prêté 40.000 à 50.000 francs pour les aider à commencer une affaire et il sera remboursé au bout d'un an.

Il dit qu'il n'a pas d'argent à épargner car les temps sont durs. Pour cela il ne participe à aucune tontine ou caisse. Mais en 5 ans, il a pu construire une maison, investir dans 30 moutons, 15 chèvres, 4 têtes de bétail et 5 hectares de plants de mil. Il n'a pas le statut de garde-argent pour diverses raisons : il ne s'est pas encore fait une réputation dans le domaine et il est encore trop jeune : il a 35 ans.

CHAPITRE IV - ANALYSE CRITIQUE DU DISPOSITIF LEGISLATIF ET DE FONCTIONNEMENT DU SYSTEME EU EGARD L'INTERMEDIATION FINANCIERE POUR LES DEMUNIS

Une bonne intermédiation qui prendrait en compte les besoins en services financiers des pauvres, devrait se concevoir dans un environnement juridique et réglementaire approprié, qui tienne compte de la spécificité des populations cibles. Elle devra s'inscrire dans un cadre macro économique favorable et présuppose des mesures qui ne provoquent pas de distorsions dans l'économie. Une bonne intermédiation financière devrait se faire avec des institutions qui remplissent les conditions d'une viabilité certaine et d'une accessibilité réelle.

I - ELEMENTS CRITIQUES DU DISPOSITIF ET DU SYSTEME EXISTANT

A – CRITIQUE DU DISPOSITIF LEGAL ET REGLEMENTAIRE

Un système bancaire assaini...

A l'examen du plan d'ajustement du secteur financier, l'option politique cadre bien avec l'objectif de relance effective de l'économie tout en portant des correctifs aux insuffisances caractéristiques du système post crise ayant induit l'instabilité des prix. Les mesures prises ont été élaborées dans le sens d'une plus grande protection de la clientèle en faisant jouer la concurrence entre banques. C'est d'ailleurs ce qui motive l'interdiction qui leur est faite de tout protocole interbancaire ou de n'importe quelle autre entente. Il y va de même pour l'obligation qui leur incombe, d'informer rigoureusement le public sur les taux qu'ils appliquent notamment par la diffusion de leur grille des taux d'intérêt et commissions dans un journal d'annonces légales, et affichage obligatoire, bien en vue au niveau des guichets.
De façon certaine, ce nouveau dispositif a permis un relèvement positif du secteur bancaire qui s'est traduit par un accroissement de la liquidité du système. La structure des dépôts fait apparaître une variation de plus de 95% de l'épargne privée entre 1993 et 1995. Dans de cette dernière année, le montant de l'épargne collectée par le système bancaire s'est chiffré à prés de 345 milliards de F CFA et la couverture des concours bancaires est passée à 101,1%.

...mais recul dans le financement du secteur privé

Au niveau économique, l'inflation (autour de 2,5 aujourd'hui) a été bien maîtrisée, mais la relance de l'investissement, recherchée par la Banque Centrale, notamment par le jeu du taux d'escompte (14,5% en 1994 ; 6% aujourd'hui), n'a pas suscité une réaction positive des banques commerciales.

Bien au contraire, le plafonnement du taux d'intérêt débiteur au taux d'usure, (double du taux d'escompte) et son corollaire, la réduction des marges, ont induit un désintérêt des banques vis à vis d'un secteur privé en perte de crédibilité. Les chiffres à ce niveau sont éloquents. Les crédits à l'économie, 355,8 milliards de F cfa en 1996, ont décru de 16,5% par rapport à leur niveau de 1993 et portent pour plus de 50% sur du court terme. La structure des emplois et des ressources des banques laisse apparaître entre 1993 et 1994 un taux de couverture des risques de 78,8% à 115,2%, en relation notamment avec la contraction des crédits de campagne. (441,5 millions en 1995 contre 12,7 milliards en 1994). Aussi, à l'instar des autres entreprises, *"les banques sont-elles sensibles à la relation rendement risque et réagissent de manière rationnelle aux variations de cette relation. Pour un niveau de risque donné, elles investiront davantage si le rendement attendu augmente, et cette relation n'est pas étrangère à l'allocation entre le marché monétaire et celui des prêts à l'économie." (Diery Seck, Etude du marché du crédit au Sénégal, in document de recherche CREA).*

Dans ce contexte généralement défavorable, une sélection de la clientèle est de rigueur, au niveau des principales banques et, bien évidemment, s'opère au détriment des petites entreprises et des plus pauvres. Cette situation, pourrait être liée au niveau de l'épargne actuelle (12,5% du PIB), jugé très faible en rapport au besoin de financement des investissements. De l'avis des spécialistes, il en faut le double pour assurer une relance convenable des investissements productifs qui conditionnent la croissance économique.

Une ouverture timide vers le financement décentralisé

Globalement les règles prudentielles auxquelles la loi soumet les institutions mutualistes sont un ensemble riche et varié, et sont la contrepartie d'avantages fiscaux et autres, qu'elles peuvent tirer de leur nouveau statut surtout si elles se constituent en réseau. Aussi, c'est un fait, la réglementation bancaire et le nouveau dispositif régissant le système financier sont plus étendus dans l'adoption d'une nouvelle gamme de produits et services financiers. Cela est perceptible, d'abord dans le fait que les services proposés tiennent beaucoup compte des exigences et des besoins de la population. Cela est perceptible ensuite dans la possibilité qu'ont les institutions de créer en cas de besoins, et dans les limites fixées par le dispositif prudentiel défini par la loi, des sociétés de services en vue de satisfaire les besoins de leurs membres.

Toutefois, l'innovation constatée dans cette nouvelle loi a une portée limitée et les nouvelles dispositions ne sont pas forcément compatibles avec le développement de l'intermédiation financière pour les populations les plus pauvres. Les limites du dispositif tiennent à plusieurs facteurs :

- L'ouverture opérée dans le cadre des nouvelles dispositions réglementaires n'est pas étendue, au point de favoriser une plus grande implication d'opérateurs privés dans le système de la micro finance. Aujourd'hui, pour être intermédiaire financier reconnu par

l'État, seules 2 options sont permises : il faut soit être dans la catégorie des banques (minimum de capital de 1 milliard de francs Cfa), ou établissements financiers (avec un capital de 300millions F CFA); soit être dans celle des structures coopératives ou mutualistes, des projets ou des ONG. Les dispositions de la loi sont strictes sur la question à tel point que même la reconnaissance des groupements d'épargne et de crédit ne leur confère pas la personnalité morale. Ce qui a pour effet de limiter leur marge de manœuvre
Pour les structures mutualistes et coopératives, c'est dans leur caractère intrinsèque, notamment le principe collectif et égalitaire de la propriété, leur but non lucratif que se trouvent les facteurs obstruant la productivité impérative à leur viabilité. Quant aux projets et ONG, nonobstant le caractère provisoire de leur autorisation d'exercer, ils sont rarement animés par un souci de pérennisation et leur intervention, généralement ciblée, ne favorise pas une grande accessibilité.
L'ouverture opérée par l'article 6 de la loi gagnerait à être plus étendue en procédant à une reconnaissance d'office de toutes les pratiques à la base. En pareil cas, seule la non-reconnaissance ferait l'objet d'une notification. L'option, telle que choisie aujourd'hui, a eu pour effet de casser les dynamiques financières à la base, en les incitant vers un modèle organisationnel pas forcément adapté aux réalités des différents milieux défavorisés.
- l'État, dans sa politique macro économique, de concert avec les autorités monétaires, cherche à promouvoir la relance par l'investissement à travers des taux d'intérêt incitatifs. L'option, louable par ailleurs, a un effet considérable sur la promotion des grandes entreprises qui remplissent les conditions et garanties nécessaires. Cette option a favorisé au niveau de ces entreprises une utilisation intensive du capital (malgré l'éviction du marché du crédit dont font l'objet les plus démunis) au détriment de la main d'œuvre (malgré le contexte de chômage important que traverse le Sénégal et qui touche particulièrement les plus démunis). Ceci s'est donc traduit par l'orientation des capitaux vers des projets d'investissement à basse productivité économique et vers un rapport dette/ fonds propres malsain pour les entreprises bénéficiaires des largesses du système bancaire. Ce choix du "développement par le haut", opéré par les pouvoirs publics se confirme dans le processus de désintermédiation qui se manifeste dans l'ouverture du marché monétaire aux grandes entreprises et par l'institution très prochaine de la bourse des valeurs.
Mais si la baisse du taux d'intérêt a un effet relativement favorable sur la grande entreprise, elle ne joue pas en faveur d'une grande accessibilité des pauvres au financement et décourage l'épargne. Déjà, avec la limitation des taux d'intérêt débiteur et leur indexation sur le taux d'usure, l'arbitrage rendement/risque des banques s'opèrent au détriment du financement du secteur privé et davantage, à l'encontre des opérateurs les plus démunis ne pouvant faire valoir une garantie sérieuse. Pour ce qui les concerne, les mutuelles d'épargne et de crédit du Sénégal sont des structures encore à l'état embryonnaire, généralement de taille modeste et d'une santé financière fragile. A l'instar des structures

informelles, elles ont donc besoin d'être renforcées par des taux d'intérêt rémunérateurs pour les prêts consentis, et se doivent aussi d'appliquer des taux d'intérêt créditeurs conséquents pour susciter l'épargne des sociétaires. Le niveau actuel du taux d'escompte, 6% n'est pas pour encourager la rentabilité financière des expériences décentralisées qui se voient contraintes d'enfreindre la réglementation en vigueur. Enfin, les révisions du niveau du taux d'escompte, opérées par les autorités de la Banque Centrale (12 en 4 ans) nécessitent des adaptations financières difficilement réalisables, eu égard au faible niveau de maîtrise technique des opérateurs des systèmes décentralisés.

D'autres problèmes à circonscrire

Des insuffisances résident dans "le manque de volonté " des autorités publiques à faire respecter les contrats ; dans la lenteur des procédures judiciaires, notamment dans le traitement des dossiers contentieux. *"Faire respecter les droits des créanciers lorsque cela est nécessaire, diminue les coûts des transactions des intermédiaires financiers. Cela peut modifier leur façon de se comporter face aux risques liés à leurs transactions avec les pauvres." (Fodé NDIAYE, Finance et développement rural au Sénégal, in Document de recherche du CREA).*

Il en existe également au niveau de l'accès à la propriété foncière qui demeure un problème encore non résolu. Dans l'état actuel des choses, si en zone rurale, l'usufruit de la terre revient aux populations, c'est l'État qui en détient la propriété. Du transfert de la propriété foncière au profit de ces populations pauvres, pourrait découler un élément de valeur, à mesure de constituer un élément de garantie, et donc le plus grand intérêt des intermédiaires financiers dans la transaction avec ces derniers.

Si l'environnement juridique et institutionnel comporte des facteurs limitants, l'environnement économique et social n'est pas non plus favorable au développement financier mutualiste. *"On en veut pour preuve, les diverses expériences malheureuses de caisses, ONG et sociétés de développement qui rendent les populations méfiantes à l'idée de création de mutuelles d'épargne et de crédit, soit les amenant à considérer le crédit comme une subvention ou à croire que le crédit doit précéder l'épargne. Qu'on pense aussi à l'absence de circuit de commercialisation des produits agricoles rationalisés qui est l'un des principaux facteurs empêchant l'accroissement des revenus des ruraux, donc leur capacité d'épargne."*

B - CRITIQUE DES SYSTEMES EXISTANTS

Nous avons vu à travers les séquences précédentes que l'environnement financier sénégalais est composé de plusieurs systèmes, bancaire, décentralisé et traditionnel informel, qui coexistent sans une réelle articulation entre eux. Quelques expériences de partenariat méritent tout de même d'être soulignées, mais sont encore trop jeunes pour que l'on puisse s'avancer sur leurs résultats. Il s'agit notamment de celles initiées entre la CNCAS et les GPF, PAPEC, et PAGF. Il en est de même entre le CMS avec le PMR et les GPF ; ou encore entre le CBAO et PAME/AGETIP.

Le système traditionnel a l'avantage d'être né d'initiatives à la base et repose sur les réalités propres du milieu. Son fonctionnement est simple, pas coûteux et n'exige pas une grande compétence managériale. Il faut toutefois se garder de surestimer ses performances. L'exemple de Mbathio est là, pour prouver que les solidarités et valeurs sociales ne sont pas forcément gages de sécurité de l'épargne.

Les tontines ont un impact très limité en raison d'un calendrier de remboursement rigide ; un risque de démantèlement du groupe lié aux périodes d'attente trop longues avant d'obtenir des fonds; le remboursement de la totalité des fonds à la fin du cycle, qui ne laisse rien au renforcement de l'institution par la capitalisation (exception faite des rares tontines qui pratiquent l'intérêt et qui prévoient la constitution de réserves). Les tontines au Sénégal sont donc limités dans le choix des investissements 1°) aux investissements des membres, 2°) aux investissements à court terme, limitant ainsi fortement l'intermédiation financière.

Le système de garde-monnaie, s'il permet de réinjecter l'épargne dans la consommation, ne bénéficie nullement aux villageois dont les dépôts ne sont pas rémunérés.

L'épargne traditionnelle sous toutes ses formes est une thésaurisation d'argent, de matières précieuses, soumis à tous les risques de vol, d'incendie, ... et à fonction souvent d'ailleurs ostentatoire.

Le système financier décentralisé est constitué par des institutions formelles très jeunes, qui cherchent encore leurs voies. Si celles d'entre elles qui sont fortement appuyées par des bailleurs de fonds connaissent une expansion rapide avec des stratégies de pérennisation définies, la plupart évoluent dans un contexte de pilotage à vue et ne se concentrent pas sur la viabilité financière et organisationnelle. Pour l'essentiel des SFD mises en place avec le concours de partenaires extérieurs, les structures sont le plus souvent sous l'emprise des seuls techniciens. Les projets devraient se transformer dès leur démarrage en des entreprises gérées par leurs bénéficiaires pour faire jouer la démocratie économique visant leur réussite en obtenant l'équilibre financier de leur fonctionnement. Cet objectif n'est réalisable que si les responsables locaux sont dès le départ pleinement associés à toutes les

décisions de gestion, ce qui constitue le lieu pratique de leur formation et la condition d'une véritable appropriation de leurs structures.

Les SFD ne développent pas de politiques efficaces de mobilisation d'épargne. De ce fait, elles ne bénéficient pas de la confiance des banques, nécessaire à leur refinancement. L'essentiel des SFD intervenant dans le pays, sont concentrées dans des zones à forte potentialité, entraînant du coup une concurrence négative qui ne bénéficie ni aux populations, ni à la viabilité des structures elles-mêmes. Elles se positionnent plus en adversaires qu'en institutions complémentaires qui doivent confronter et échanger leurs expériences en matière de performances opérationnelles et financières, leurs portées et leurs innovations.

II - ELEMENTS DE PERFORMANCE DANS LES SYSTEMES EXISTANTS

Cette partie sera traitée plus en détail dans le deuxième dossier. Cependant certains éléments qui ont donné naissances à des "success stories" seront évoqués pour voir dans quelle mesure le système de financement décentralisé peut s'en inspirer afin d'améliorer son accessibilité et sa pérennité.

A - EN MATIERE DE POLITIQUE GENERALE : CAS DU SYSTEME BANQUES[8] VILLAGEOISES CRS

L'organisation Catholic Relief Services a été le moteur de la création et de la gestion de banques villageoises au Sénégal depuis 1989. Il s'agit là d'un système financé par l'USAID et qui fonctionne à l'image des systèmes bancaires d'origine FINCA dans les zones rurales.

Le dispositif met en jeu 3 types de partenaires, à savoir 1 bailleur (l'USAID, à travers le CRS) ; 1 ONG (entente des groupements) et les banques villageoises.

Le CRS fournit les fonds que l'Entente utilisera pour octroyer des prêts aux Banques villageoises et il fournit une formation en matière de gestion et de supervision des Banques villageoises. L'Entente est l'intermédiaire entre les Banques villageoises et le CRS. Elle est responsable de la formation et de la supervision du comité de gestion de chaque banque mais aussi de leurs activités financières et de l'attribution des fonds d'emprunts aux banques.

Une fois mises en place, les Banques villageoises fonctionnent de manière relativement autonome avec une certaine formation, sous la surveillance de l'Entente et parfois du CRS. Tous les registres sont tenus au sein des villages et sont conservés par le secrétaire. Au

[8] Le terme banque est utilisé ici de façon abusive si l'on se réfère à la loi bancaire qui attribue le titre de Banque à une institution, qui entre autres conditions, dispose d'un capital minimum de 1 milliard de CFA.

cours des réunions mensuelles, le comité de gestion reçoit et enregistre l'épargne des membres et débourse les prêts aux membres et non - membres en puisant dans les fonds récoltés. Un contrôleur de l'Entente jouera le rôle d'observateur et aidera au déroulement des réunions mensuelles.

La structure est fortement décentralisée, la plupart des décisions et la gestion étant assumée par les membres des banques villageoises.
Les objectifs sont financiers, développer l'épargne pour accumuler et garantir la richesse personnelle et utiliser le crédit comme un moyen d'accroître cette richesse, mais également sociaux dans la mesure où le développement de la communauté est censé découler de la participation de cette dernière à la gestion des banques villageoises.
Un objectif à long terme est qu'après trois années et demi de fonctionnement, chaque banque villageoise ait accumulé l'épargne et l'expérience nécessaire pour continuer sans assistance extérieure. L'objectif ultime de CRS est d'instaurer un système de financement alternatif qui relierait les institutions informelles et formelles par une institution chapeautant le tout qui acheminerait les fonds entre le secteur bancaire commercial et les banques villageoises et vice versa.

Services d'épargne

Outre le montant d'épargne symbolique de 2.000F cfa avec lequel un membre débute son compte d'épargne, les membres s'engagent à épargner un montant précis au cours du cycle de prêts de six mois. Dans la mesure où tous les membres de ce système reçoivent des prêts, ils sont également tous des épargnants. L'engagement d'épargner est satisfait par des versements identiques à chaque réunion mensuelle.
Les transactions d'épargne sont reprises dans le livret d'épargne des membres, ainsi que dans les registres de la banque conservés par le comité de gestion. Les transactions s'effectuent devant les membres au cours des réunions mensuelles ordinaires. Les membres ne reçoivent pas d'intérêt sur leur épargne. Un membre qui souhaite retirer son épargne peut le faire à la fin du cycle de prêt mais il ne pourra pas rester membre s'il effectue ce retrait.

Services de crédit

L'octroi de prêts se fait sur base de cycles de six mois, qui commencent début juillet et début janvier. Ces dates ont été choisies car dans les économies rurales dans lesquelles fonctionnent les banques, elles ne sont ni le meilleur moment ni le pire aux yeux des membres.
La théorie qui sous-tend ce raisonnement est que si les liquidités sont disponibles à partir de la moisson (février /mars), les membres ne pensent pas à des possibilités

d'investissements. CRS soutient en revanche, que lorsque l'argent est plus rare (au cours des mois secs d'avril/mai), les membres auront plus tendance à dépenser le montant de leur prêt à la consommation plutôt que pour des activités productives.

Les banques proposent trois types de prêts qui se différencient les uns des autres par leur source de financement. Certains prêts sont uniquement accessibles aux membres, d'autres sont disponibles pour tous.

- Prêts fondés sur des comptes externes : Ils sont consentis pour une période de 6 mois à un taux d'intérêt de 15% pour la période, soit 30% par an. La banque prête ces fonds aux membres uniquement. La taille des prêts peut augmenter petit à petit de 15.000F cfa au premier cycle à 150.000F cfa pour le 7ème cycle. L'intérêt et le principal sont dus et payables en un seul versement au terme du prêt.
- Prêts fondés sur le premier compte interne : le premier compte interne est défini comme étant le "profit" cumulé de chaque banque villageoise plus l'épargne des membres au cours du cycle de prêt. Les banques ont en réalité, un " profit " nominal car elles empruntent auprès de l'Entente à un taux de 8% et prêtent à 15% pour un cycle de prêt de 6 mois. Ces fonds sont prêtés aux membres et non-membres pour des périodes de 1 mois à un taux d'intérêt mensuel de 10%.
- Prêts fondés sur le deuxième compte interne : L'épargne cumulée des membres évolue. Les banques investissent ces fonds de deux manières : une partie déposée auprès d'une banque et l'autre prêtée aux membres et non-membres à 25% d'intérêts pour une durée de cinq mois. Le taux d'intérêts moyen récolté sur tous les prêts octroyés évolue de 27% par cycle, soit 54% par an. Tous les membres qui sollicitent un prêt se le voient octroyer et la grande majorité d'entre eux demandent un montant inférieur au plafond autorisé. Il n'existe pas non plus de critère de crédit pour les non-membres, bien qu'une certaine forme de prêt, fondée sur la réputation soit probable et implique que les villageois de réputation douteuse seront exclus.

Aucune garantie n'appuie la demande de prêts. Le système s'appuie plutôt sur la solidarité au sein d'un groupe ou sur les garanties mutuelles. Si un membre est en défaut de paiement, la banque a le droit de saisir ses actifs et de les vendre afin de rembourser le prêt par le produit de la vente.

Performances

Accessibilité : Les banques ont un effet direct qui va au-delà de leurs membres, constitués exclusivement de femmes (100%), puisque les non-membres peuvent recevoir des prêts. En termes de pénétration du marché, une distinction s'impose entre le nombre total de membres potentiels pour les banques et l'ensemble des banques admissibles. Les membres

potentiels incluraient tous les résidents de l'arrondissement qui ont atteint l'âge de la majorité.

D'après les observations et les analyses menées dans le cas de NGANDA, il est apparu que la plupart des membres des Banques villageoises sont des personnes à très faibles revenus, qui vivent dans une région relativement isolée du Sénégal. Des 600 prêts octroyés aux membres au cours du premier cycle de prêts, la taille moyenne des prêts était de 33 800 F cfa (US$ 67) soit 15% du PNB par habitant du pays.

Dans l'optique purement financière, la qualité des services offerts est inégale. Une partie des prêts proposés par les banques est disponible toute l'année, ceux financés par le premier compte interne. Il s'agit d'un système très bien adapté qui permet aux membres et non-membres d'avoir accès au crédit presque sur simple demande, les emprunteurs pouvant ainsi répondre aux occasions d'investissements et aux nécessités familiales au moment où elles se présentent. Les autres prêts (du compte externe ou du deuxième compte interne) sont disponibles au début de chaque cycle de six mois seulement.

Viabilité : Entre juillet et décembre 1994, les revenus d'intérêts engendrés par 12 banques mises en place par l'entente de NGANDA, sont estimés couvrir 160% des coûts de fonctionnement et 123% du total des coûts de fonctionnement et des coûts financiers. En d'autres termes, avant prise en compte de l'inflation, les Banques villageoises du Nganda sont rentables. Il s'agit là d'un exploit remarquable, qui résulte de la fixation de taux élevés des prêts (54% en moyenne annuelle) et d'une structure de coûts de fonctionnement et administratifs très faibles. Le fait que les banques combinent l'épargne des membres avec l'endettement de l'Entente améliore considérablement les bénéfices pendant les 3,5 années de tutelle (les prêts en tant que multiple de l'épargne ont varié de 4 fois l'épargne en juillet à 2,5 fois l'épargne en décembre).

Dans leur fonctionnement actuel, les banques villageoises sont subventionnées uniquement sur certains aspects : la formation des gérants, l'inspection/contrôle, les supports de gestion et une ristourne des intérêts payés sur les prêts de l'entente. Les banques deviendront encore plus rentables avec l'augmentation de la taille des portefeuilles. Le montant des prêts va s'accroître au fur et à mesure que les emprunteurs sollicitent des montants plus importants et qu'une grande quantité d'épargne peut être prêtée.

Une autre condition de viabilité provient du fait du partenariat Bailleur/ONG/Entente. Ce système de partenariat comprend quatre éléments clés. En premier lieu, elle fait valoir que les banques commerciales (qui doivent se substituer aux bailleurs), ont un rôle important à jouer en consacrant certaines de leurs ressources à l'octroi de crédits aux plus démunis. Les commerçants ou certains autres privés peuvent remplir ce rôle mais sont exclus par la loi actuelle. En deuxième lieu, elle met en avant l'utilisation des stratégies de groupes, c'est à dire l'organisation des emprunteurs pauvres en groupements qui les pourvoient d'un réseau

de soutien mutuel et garantissent des taux de recouvrement élevés. D'une façon générale, plus démunis sont les emprunteurs, plus important est le rôle potentiel de ce type de groupement en tant que moyens de toucher les milieux défavorisés et de répondre à leurs besoins. En troisième lieu, cette approche admet que les ONG ou implantées dans les communautés disposent, en général, d'un avantage comparatif sur les banques commerciales. Elles parviennent effectivement à toucher les populations pauvres du fait de facteurs comme la proximité, la confiance, l'engagement, la souplesse et la réactivité. Les ONG compétentes (au fur et à mesure qu'elles existent) ont donc un rôle vital à jouer, à titre soit d'intermédiaires financiers qui empruntent aux banques et reprêtent aux groupements, soit d'intermédiaires non financiers qui identifient les bénéficiaires, créent et forment les groupements. Enfin cette approche reconnaît combien il est important d'asseoir l'octroi de crédits aux déshérités sur une base durable et viable au plan commercial.

B - EN MATIERE DE PROCEDURES : CAS DE ACEP

Les critères de performance qui ont conduit au choix de cette structure résident dans sa procédure de gestion et de suivi du crédit.

Les objectifs de l'alliance de Crédit et d 'Epargne pour la Production (ACEP) sont de fournir des services d'épargne et de crédit aux entrepreneurs de micro activités économiques dans le but d'appuyer la croissance de leurs entreprises.

Présentation

La création de ACEP remonte à 1985 et émane d'un projet USAID, en collaboration avec le gouvernement du Sénégal. L'année 1993 marque le désengagement de l'USAID et amène la structure à faire le choix de son nouveau statut juridique qui devient une mutuelle d'épargne et de crédit faute d'alternative légale.

Les partenaires techniques et financiers actuels de ACEP sont l'USAID, le FENU, le CRS, la CFD, l'ACDI et la SDID.

Dans son fonctionnement, le dispositif mis en place par ACEP fait intervenir des organes techniques et des organes électifs fonctionnant sur les principes de la mutualité.

Les organes techniques sont la direction générale ; le secrétariat général, l'audit interne ; les bureaux régionaux et locaux. Les organes électifs sont l'assemblée générale des adhérents qui est l'organe suprême ; le conseil d'administration composé de membres élus ; le comité de crédit ; le conseil de surveillance.

Les membres élus de la mutuelle sont bénévoles tandis que le personnel technique et administratif est salarié de la structure. En plus de leur salaire fixe, les responsables des différents bureaux perçoivent une commission de 5% sur le résultat net de leur bureau.

Gestion du crédit

Dans le principe, la décision d'octroi de crédit emprunte le cheminement suivant :
La logique de proximité exige du promoteur qu'il s'adresse au bureau local de l'ACEP dans sa zone d'implantation. Le responsable de bureau instruit le dossier en se basant sur des éléments qu'il aura vérifiés en situation et sur les conseils des adhérents membres du conseil de son bureau local. Le dossier techniquement monté, est transmis au niveau du bureau régional et à charge pour le responsable régional d'opérer une contre visite permettant de confirmer les éléments constitutifs du dossier. Une fois par mois, tous les responsables de bureaux régionaux et locaux tiennent un comité de crédit présidé par le directeur général avec la participation du secrétaire général, du responsable juridique et de l'essentiel de l'équipe technique. Dans ce comité, tous les dossiers sont passés au crible et seuls ceux qui font l'unanimité sont éligibles au financement. Ces dossiers validés retournent au niveau des bureaux locaux et passent devant la commission locale de crédit qui statue sur les éléments relatifs au montant sollicité, à la durée requise...
Le responsable du bureau local est tenu d'assurer le suivi des prêts et devra faire un rapport régulier sur l'évolution de l'activité et de la situation du promoteur. Dans le principe, les échéances sur crédit sont honorées le premier de chaque mois. Si les règlements ne sont pas effectués dans un délai supérieur à 5 jours, la direction générale est tout de suite saisie et délègue une mission sur le terrain pour s'enquérir des raisons effectives qui ont motivé ce retard. Si les motifs relèvent de la mauvaise volonté, le promoteur reçoit un avertissement et ne pourra plus bénéficier des services de ACEP. S'il s'agit de problèmes pouvant entraîner la faillite de l'opérateur dans son activité, ACEP se dépêche de prendre des mesures nécessaires pour rentrer dans ses fonds. Grâce à cette gestion rigoureuse du crédit, ACEP arrive à un taux de recouvrement qui avoisine 99%.
Le réseau ACEP a été évalué par plusieurs audits. Elle est reconnue par tous les experts comme l'institution financière la mieux gérée et qui obtient de bonnes performances. Le secret de ACEP repose sur la combinaison de certains principes de la mutualité et de la rigueur bancaire au niveau de la gestion des crédits. Elle dispose par ailleurs d'un encadrement technique d'une grande qualité, rémunéré en fonction des résultats obtenus. Avec une augmentation de 5548 membres, ACEP témoigne d'un taux de pénétration en nette amélioration et d'une grande vitalité financière. Même si elle continue de bénéficier de subventions, celles-ci ne s'opèrent que sur les aspects institutionnels et non sur le taux d'intérêt, et tendent à diminuer avec le temps. Le résultat net de l'exercice 1996, sur 15 mois, se porte à 510,7 millions de francs.

C - EN MATIERE DE PRODUITS : CAS DU SERVICE FINANCIER POSTAL

Le choix de cette structure réside dans le fait qu'en plus du service épargne, elle est l'institution la plus décentralisée du Sénégal qui offre le service de transfert.

La Caisse Nationale d'Epargne et le Centre Chèques Postaux constituent deux structures de la direction des clientèles financières de la poste sénégalaise. Ils ont pour vocation principale la collecte et la mobilisation de l'épargne intérieure au service du développement national. Ils utilisent le réseau postal classique fort de 130 bureaux et de 2 agences. La loi ne leur permet pas d'octroyer du crédit.

Epargne

Avec 4,5% d'intérêt sur épargne, la CNE offre le taux le plus rémunérateur du marché. Elle sert à sa clientèle détentrice de 225.000 comptes (au 31/12 96), 0,5 points de plus que le taux minimum imposé par la BCEAO.

Les conditions d'ouverture de comptes CNE sont accessibles. Avec un minimum de 5.000F cfa et sur simple présentation de pièce d'identité on peut être titulaire d'un compte d'épargne. Elle offre également à ses membres la possibilité d'épargner de petits montants sans qu'aucune limitation ne soit appliquée.

Avant il y avait une très forte centralisation dans la gestion des comptes postaux qui faisait qu'une demande d'ouverture ou de retrait d'argent dans un bureau de poste, empruntait la voie postale pour être enregistré au niveau de la direction centrale de Dakar. La lenteur était ainsi l'élément caractéristique du système postal. De plus en plus des efforts ont été opérés avec notamment l'utilisation du système de fax et de télex pour promouvoir la rapidité des transactions. Depuis 1988 le système CNE adopte le principe de la localisation des comptes, offrant à chaque client la possibilité de domicilier son compte dans le bureau de poste de son choix.

Pendant longtemps, les fonds collectés auprès des guichets étaient déposés au trésor public qui les rémunérait à un taux d'intérêt de 10%. Avec les difficultés financières du Trésor Public, les épargnants avaient des problèmes pour accéder à leur épargne. Mais depuis la restructuration du système bancaire intervenue en 1989, et qui a vu naître un regain d'intérêt pour la CNE, la Poste n'est plus tenue par le Trésor Public et a désormais la possibilité de recourir au marché monétaire pour placer ses fonds. Elle a en plus, adopté un système de réserves pour les retraits avec possibilité de renforcer les caisses par les dépôts enregistrés. Cette nouvelle situation a eu pour effet de résoudre le problème de disponibilité de l'épargne.

Dans le domaine des innovations, la CNE propose de nouveaux produits qui ne sont disponibles, nulle part ailleurs dans le financement décentralisé. Il s'agit de la carte de retrait et du plan d'épargne retraite complémentaire (PERC), mis en place en collaboration avec la Compagnie Sénégalaise d'Assurances et de Réassurance (CSAR).

Transfert

Le service transfert postal est offert à tous quel que soit le lieu de résidence sur le territoire national sans conditions préalables et n'est pas sujet à rémunération pour le destinataire, exception faite des transferts internationaux.

Dans le système CNE, on peut se faire payer dans n'importe quel guichet dès lors qu'on est titulaire d'un compte. Des réflexions sont en train d'être menées en vue d'une informatisation du réseau et l'adoption du système de transfert électronique et des négociations, sont entreprises avec Western Union dans le sens d'une plus grande efficacité dans le système du transfert. L'amélioration dans le domaine du transfert a induit de nouvelles opportunités d'affaires pour le système postal qui, en 1996 s'est enrichi de la coopération avec la BRED qui utilise son réseau pour payer la pension retraite des français au Sénégal.

Grâce à la performance du système et à la densité de son réseau, la CNE assure le transfert des fonds des migrants qui rapatrient régulièrement leur épargne au Sénégal.

D - EN MATIERE DE STRATEGIES : CAS DES CVECA

Ici, il sera fait référence à une expérience originale initiée par le Centre International de Développement et de Recherche (CIDR), au Mali[9] qui développe des stratégies innovantes renforçant les éléments de viabilité. Par CVECA, il faut entendre Caisses Villageoises d'Epargne et de Crédit Autogérées du pays Dogon.

Présentation

En 1995, le réseau était constitué de 54 caisses avec 18.691 membres dont 1/3 de femmes. Il a mobilisé 247,5 millions de francs cfa d'épargne locale, octroyé 11.218 crédits pour un volume de 378 millions de francs cfa, en canalisant plus de 100 millions de francs cfa de refinancement bancaire. En 10 ans d'existence, le taux de recouvrement a toujours dépassé 98%.

[9] Le Mali appartient à l'UEMOA et est donc assujetti au même régime monétaire que le Sénégal.

Stratégie de réduction des coûts

Les bailleurs de fonds et l'État malien ont supporté les coûts externes tandis que les acteurs bénéficiaires contribuent à la diminution des charges du projet en acceptant de supporter eux-mêmes certaines charges internes. De même l'honnêteté des villageois a permis d'économiser sur les frais financiers et les dépenses de sécurité. Par ailleurs les villageois ont participé à la construction des caisses et les membres du comité font du bénévolat quant à la gestion des caisses (animation, formation, sensibilisation des populations, etc.)

Les services centraux habituels des réseaux classiques, tels que Caisse centrale ou cellule technique, coûtent chers, sont lourds à gérer, deviennent des bastions de pouvoir, souvent bureaucratiques et technocratiques, coupés de la base du sociétariat. Ils sont indispensables, certes, selon leurs fonctions. Aussi, les Caisses villageoises du pays Dogon ont-elles externalisé ces fonctions en confiant à 2 entreprises :

- La fonction de Caisse centrale a été confiée à une banque partenaire. Celle-ci sécurise et rémunère les quelques fonds "externes" dont disposent les unions, tels que les fonds d'assurance, le fonds d'innovation et le fonds de garantie constitué au cas par cas pour accéder au refinancement. Elle mobilise sur le marché monétaire et auprès des bailleurs de fonds, les ressources nécessaires pour refinancer les unions.
- La fonction Cellule technique est prise en charge par une entreprise privée locale, un groupement d'intérêt économique (GIE) prestataire de services, crée par 3 cadres du projet qui passe un contrat annuel de prestations payantes avec les 3 unions. Chaque année, les 3 unions se réunissent, définissent un cahier de charges des services d'audit, de formation, d'appui technique et de conseil, de mise en relation et de représentation négociation qu'elles souhaitent voir couvrir par le GIE et négocient avec celui-ci le délai (durée, calendrier, date de remise des travaux) et le budget en conséquence.

Pour sa part, le réseau des caisses villageoises ne paie que pour les prestations utilisées et n'a pas de charges fixes. Il met le GIE en concurrence avec d'autres offres potentielles pour maintenir la pression sur la qualité des services rendus et même sur les coûts.

*La stratégie d'*autofinancement

Pour préserver les caisses de base lorsque certains éléments du réseau s'effondrent ou disparaissent, l'option a porté sur l'emploi sur place de toutes les ressources locales afin de maintenir l'argent dans le village. Et pour que les liquidités ne soient pas immobilisées longtemps dans les coffres, les décisions d'octroi de crédit sont entièrement prises par le comité de crédit local sans autre présence extérieur. A chaque remboursement, il se réunit, décide et, en moins de 24 heures, l'argent repart sous forme de crédit.

Toutes les charges de fonctionnement de la Caisse sont couvertes, dès l'origine, par la Caisse elle-même, soit à partir de ses résultats, soit à partir de cotisations exceptionnelles

auprès des membres. Ainsi même dans le cas où le réseau tout entier disparaîtrait, la caisse villageoise peut continuer à fonctionner de manière autonome.
Par esprit de solidarité, les groupes de village acceptent volontiers de faire des dépôts à la caisse.

Les innovations

Les promoteurs ont choisi de mener des recherches et des actions avec les acteurs économiques locaux.
Parallèlement aux caisses villageoises qui octroient des crédits en fonction des demandes et restaient souvent cantonnées dans de petites activités de survie, une démarche plus volontariste et systématique a été mise en place.
En 6 ans, il a été mené des recherches sur les petites filières économiques qui paraissaient prometteuses, en associant des petits entrepreneurs dans des tests d'innovation économique.
Ces tests ont globalement porté sur 3 directions :
- des tests techniques, alliant des savoir-faire traditionnels artisanaux de qualité avec des éléments industriels ou technologiques pour faciliter la commercialisation et réduire les coûts. Ce fut le cas de la fabrication des pagnes mieux finis ou encore l'élargissement de la gamme de produits des forgerons locaux.
- des tests organisationnels, où des filières villageoises se mettent en place avec des producteurs, contractualisant avec un grossiste villageois, chargé de regrouper la marchandise et d'aller l'écouler sur des marchés extérieurs.
- des tests d'extension géographique vers des marchés régionaux pour toucher une clientèle plus nombreuse et à pouvoir d'achat plus fort, moins tributaire des contraintes locales.
Par ailleurs, le fonds de recherche a financé des voyages d'étude, permettant à des groupes de micro entrepreneurs Dogon d'aller voir des expériences ailleurs, de discuter avec d'autres entrepreneurs de leurs expériences, de se faire une idée des différentes possibilités.
Il a également servi à financer certaines formations en techniques nouvelles. Le fonds d'innovation était conçu comme un fonds de crédit à risque, permettant de faire des crédits, à taux modéré, à des innovateurs désirant tenter une nouvelle façon de faire (technique, organisationnel ou extension géographique).
Cette démarche a fortement marqué le milieu Dogon, traditionnellement conservateur. Elle bouscule les habitudes et suscite un malaise. En même temps elle crée une dynamique véritable où entreprendre, prendre des initiatives, affirmer ses ambitions se répand progressivement dans la société et n'est plus marginalisé qu'auparavant.

III - AMELIORATIONS SOUHAITABLES

A - RELATIVES AU CADRE INSTITUTIONNEL

Pour une ouverture à la concurrence

Une bonne intermédiation financière en faveur des pauvres ne peut s'opérer que dans un environnement concurrentiel (horizontal, avec des institutions d'un même type ; vertical, avec des institutions de taille et de spécialisation légèrement différentes) qui suppose l'existence d'une pluralité d'intervenants de natures diverses et dans lequel les règles du jeu sont clairement définies.

Au stade actuel, le maillage des institutions financières à travers le pays est fort disproportionné. Les 61 guichets de banques et établissements financiers existants sont localisés dans les principales capitales régionales du pays, avec plus de la moitié dans la seule ville de Dakar. Les 363 SFD identifiés sont irrégulièrement répartis à travers le pays, faisant apparaître des zones à forte concentration face à des zones de désert bancaire.

Dans chacun des 13.000 villages du Sénégal, il existe des opérateurs économiques qui, de fait, offrent des services financiers aux populations et qui sont, en quelques sortes, l'articulation entre le village et la ville. Une meilleure intermédiation en faveur des pauvres pourrait, à travers une plus large ouverture de la profession financière, passer par l'intégration de cette pratique traditionnelle, qualifiée d'usuraire par ailleurs, dans le dispositif institutionnel et réglementaire. Cette intégration devra, tout comme celle des groupements d'épargne et de crédit, leur conférer la personnalité morale afin de favoriser leurs meilleures relations avec les institutions formelles partenaires.

L'exemple de "Banco Sol[10]" en Bolivie prouve bien qu'il soit possible de gagner de l'argent en offrant du service financier au niveau le plus bas. Un allégement des conditions de banques pourrait donc inciter la création d'une pluralité d'institutions intervenant à différents niveaux et ainsi favoriser les conditions de concurrence en faveur de la bonne qualité des produits et services offerts aux populations.

Mais si les conditions de bonne concurrence supposent l'existence d'intervenants pluriels, elles restent conditionnées par l'existence d'un cadre institutionnel sain, dans lequel les contrats sont respectés, les procédures judiciaires normalisées, et les règles de droit appliquées.

Pour un regain d'intérêt dans la transaction financière vers les pauvres

Nous avons vu à travers cette étude, qu'en zone rurale, notamment chez les plus pauvres, les taux d'intérêt liés au crédit sont largement au-dessus de la fourchette autorisée. Nous

[10] Banco Sol est une banque commerciale privée bolivienne rentable, spécialisée dans le micro crédit.

avons vu des cas extrêmes où ils atteignent 40 à 50%[11] par jour, mais que la rentabilité induite par les activités que le crédit a financées, est telle qu'elle permet de rembourser et de dégager des bénéfices substantiels.

L'enseignement que l'on en tire est d'abord que le taux d'intérêt n'est pas en soi un facteur inhibiteur pour les populations pauvres. D'autre part, dans les situations où le volume de financement sollicité est très faible, ou le délai de paiement est réduit, l'effet d'intérêt ne joue pas un rôle déterminant. Par ailleurs, une marge d'intérêt rémunératrice peut susciter l'attrait des institutions financières et justifier l'intermédiation vers les pauvres.

Dans le contexte actuel de la désintermédiation où la bourse régionale des valeurs mobilières se met en place et que le marché monétaire s'ouvre aux grandes entreprises, des taux d'intérêt rémunérateurs ne peuvent remettre en cause la relance de l'investissement. Tout au plus, ils devront traduire un rapport rendement risque favorable, au bénéfice d'une plus grande ouverture des banques sur le secteur privé. Ce qui devra permettre l'accès au financement pour le plus grand nombre de petites et moyennes entreprises et donc le renforcement de l'investissement.

L'idée ainsi émise consiste à introduire un biais favorable au financement des micro activités. Ce qui consiste à maintenir un taux d'usure dans le financement bancaire de l'économie et à le (taux d'usure) supprimer purement et simplement lorsqu'il s'agit du financement des plus démunis à travers le système de financement décentralisé. En effet, les intermédiaires financiers s'accordent sur le fait que les coûts d'approche supportés et les risques encourus sont d'autant plus importants que le niveau de financement est bas. Par ailleurs, l'économie sénégalaise se caractérise, entre autres, par une éviction des plus démunis du système financier formel, alors que les grandes entreprises bénéficient de plusieurs opportunités de lever des capitaux qui seront d'autant plus importantes avec l'avènement de la Bourse Régionale des Valeurs Mobilières (BRVM). Dans ces conditions, la restauration d'un accès équitable au financement de l'investissement productif justifie ce biais favorable en vue de compenser les pertes potentielles et éventuelles dues à la présence de risques et de coûts de transaction plus importants dans le financement des micro activités.

Cette proposition de système à double vitesse trouve son fondement économique dans situation oligopolistique actuelle des banques de la place qui interdit de libéraliser complètement les taux, au risque confronter les consommateurs à une "surtarification" des produits financiers, malgré loi anti trust à laquelle les banques sont assujetties. Par ailleurs, pour ce qui est des systèmes mutualistes la libéralisation des taux n'est pas problématique dans la mesure où, à l'instar des caisses villageoises autogérées en pays Dogon, les membres, propriétaires de ces institutions ne s'opposent pas en général à des taux d'intérêt

[11] cela ne s'exprimant pas en année.

élevés d'autant plus que les bénéfices subséquents à l'application de tels taux leur profitent en dernier ressort et garantit la pérennité de leur institution.
La mise en œuvre d'une telle proposition s'inscrit dans la dynamique de la nouvelle politique de gestion de la monnaie et du crédit de la Banque Centrale puisqu'elle contribuera à limiter les placements des surliquidités bancaires sur le marché monétaire. Dans une telle situation, le financement des micro activités par les banques, à travers les SFD sera une alternative intéressantes pour ces dernières, les taux étant compatibles avec le niveau du risque encouru.
Cette proposition s'inscrit enfin dans la dynamique de la nouvelle politique de gestion de la monnaie et du crédit dans la mesure où sa mise en œuvre permettra une mobilisation accrue de l'épargne. Elle incitera les banques formelles à accorder une plus grande attention à l'efficacité de leurs opérations à travers l'adoption de mesure d'assainissement interne visant l'optimisation des procédures et la diminution des charges de structures et in fine, la réduction du taux de base bancaire.

Aujourd'hui, dans la finance décentralisée, la moyenne des taux pratiqués tourne autour de 18%. ACEP qui, de l'avis des experts, est l'intermédiaire le plus performant du point de vue de sa gestion, est la seule structure qui arrive à équilibrer ses comptes avec des taux de 15%. Ce qu'il faut savoir, c'est que ACEP n'intervient pas à la dimension des plus pauvres et ce, pour des raisons évidentes liées aux coûts de l'intermédiation. La libéralisation des taux dans le SFD ci dessus prônée, devrait permettre aux institutions les plus efficaces et les plus productives, un niveau d'accessibilité et de viabilité tel, qu'elles puissent fonctionner et se développer sans subventions particulières.

Pour un marché rural viable
L'accès des pauvres ruraux aux financements pourrait être favorisé par *"l'existence d'un marché primaire viable, dans lequel les opérateurs peuvent dégager des marges nettes positives et en croissance."* Les efforts entrepris pour l'amélioration des conditions de viabilité de la production en milieu rurale devront être renforcés notamment avec des subventions institutionnelles portant sur l'aménagement de périmètres irrigués, la libéralisation des circuits de commercialisation..., de sorte à permettre la solvabilité du plus grand nombre. Cela devra aussi passer par l'accès à la propriété foncière, valeur sûre, à mesure de couvrir les garanties exigées par les opérateurs financiers.

B - RELATIVES AU FONCTIONNEMENT DES INSTITUTIONS

Les conditions de viabilité d'un système financier intégrant les pauvres, si elles sont liées à un environnement institutionnel favorable, sont pour beaucoup, fonction de l'efficience des

structures financières elles-mêmes et doivent s'appuyer sur la mobilisation de l'épargne locale et de la recherche de niches dans les activités hors bilan.

Pour l'amélioration de l'efficience

L'amélioration de l'efficience des structures financières opérant en zones défavorisées pourrait découler :

... de stratégies de partenariat en vue d'une réduction de coûts d'intermédiation ;

Une étude menée en INDE (Puhazhendhi, 1995), comparant les coûts des transactions bancaires de l'octroi de crédit aux pauvres par le biais de différentes voies, conclut qu'ils sont nettement inférieurs quand la banque utilise les ONG et les groupes d'auto assistances (système à cotisation) comme intermédiaires financiers. Elle avance également que le recours à ces intermédiaires, améliore sensiblement pour les banques, la viabilité commerciale de crédit aux démunis.

... d'un renforcement des capacités des opérateurs

Le renforcement des aptitudes du personnel est une bonne solution pour améliorer l'efficience : un personnel compétent, motivé et bien formé reste dans l'organisation et contribue à la fidélisation de la clientèle et au renouvellement de la demande de services. Il est à même de faire plus d'emprunts et d'assurer de bons remboursements. Il joue un rôle particulièrement important dans le dispositif, car étant en contact ~~en contact~~ direct avec les clients. Dans le cas des mutuelles, le renforcement des capacités doit aussi s'opérer en faveur des élus afin de leur permettre une plus grande maîtrise des opérations financières et pus grande aptitude au contrôle des caisses et des techniciens.

... de méthodologies de crédit efficaces

Cela suppose des produits simples et souples, répondant aux besoins des groupes de clients et convenant aux réalités locales. Cela exclut d'office toutes politiques de ciblage qui pourrait biaiser les logiques de production.

Pour le développement de l'approche par l'épargne

La plupart des systèmes financiers ruraux solides et durables appuient leur stratégie sur la mobilisation d'épargne. Les dépôts permettent aux emprunteurs potentiels d'établir leur solvabilité de façon systématique et fournissent aux prêteurs des informations peu coûteuses et utiles dans la sélection des emprunteurs potentiels. Ils ont aussi cette faculté de réduire considérablement le besoin monétaire des prêteurs vis à vis des donateurs et des pouvoirs publics. De surcroît, ils imposent une discipline aux activités de prêts. "Une approche basée sur la mobilisation d'épargne, par le changement qu'elle opère sur l'origine

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de l'argent prêté, en change l'image et réduit conséquemment les problèmes de recouvrement des prêts."

Pour la recherche de niches dans les activités hors bilan

Il s'agit essentiellement de la possibilité offerte aux SFD de mettre en place des activités de services au profit de leurs membres. Cependant la loi bancaire, dans le cadre de son dispositif réglementaire et conventionnel, interdit aux SFD d'engager des fonds dans ces activités dépassant 5% de risques de l'institution, sauf autorisation du Ministre des Finances. Cette limite l'implication de ces SFD dans la promotion du niveau d'éducation de leurs membres et de leur santé, toutes activités dont on sait qu'elles exhibent des taux de rendement sociaux et privés élevés. La révision de cette disposition contribuerait à accroître le rendement économique des institutions décentralisées.

ANNEXES

I - LES SEUILS DE PAUVRETE

L'identification de la population pauvre pose le problème de la détermination du seuil à partir duquel la privation d'un bien pour un individu est jugée inacceptable par la société. La mesure de la pauvreté suppose implicitement qu'il existe un standard de consommation ou de niveau de vie appelé seuil de pauvreté qui doit être au moins atteint par un individu non pauvre. Il est en effet indiscutable qu'il existe des niveaux de consommation de divers biens en deçà desquels il est difficile de maintenir le corps humain en activité. Les seuils de pauvreté existent donc. Mais les points de vue diffèrent sur la définition de leur niveau. Par ailleurs, la pauvreté peut se définir au-delà de l'atteinte d'un minimum absolu nécessaire à la vie. Un individu dont le revenu lui permet de s'assurer un panier de consommation suffisante peut être considéré comme étant pauvre si sa consommation est la moins prisée de la localité dans laquelle il se trouve. La notion de seuil de pauvreté est donc non seulement relative mais aussi subjective.

1- LES SEUILS DE PAUVRETE ABSOLUS

Ils sont en général fondés sur la consommation de biens alimentaires. La détermination d'un seuil de pauvreté absolue consiste à préciser le besoin énergétique ou calorifique nécessaire au maintien en activité du corps humain. Ce besoin peut varier selon les individus mais aussi au cours du temps pour un même individu. Selon les habitudes alimentaires du moment de la localité, ce minimum calorifique correspond à un panier de consommation minimum donné. Ce seuil ainsi exprimé peut être traduit en unités monétaires grâce à la valorisation aux prix courants des biens qui composent ce panier. Ainsi, les seuils diffèrent selon les régions compte tenu des habitudes alimentaires différentes mais aussi du fait de la distorsion introduite par les prix. Le seuil ainsi déterminé est arbitraire dans la mesure où sa valeur dépend des préférences individuelles modales de la société. Cet arbitraire est inévitable dans la détermination pratique d'un seuil de pauvreté. Il existe une méthode alternative d'établissement de seuil de pauvreté. Elle consiste à considérer comme étant pauvre une proportion donnée des moins nantis de la population totale et à ériger la consommation ou le revenu correspondant à cette proportion en seuil de pauvreté. C'est également un seuil absolu.

2 - LES SEUILS DE PAUVRETE RELATIFS

Les seuils de pauvreté absolus sont en général utilisés pour mesurer la pauvreté dans le pays en développement. Les seuils de pauvreté relatifs sont utilisés dans les pays développés.

- L'indice de profondeur est obtenu en multipliant l'indice de l'écart de la pauvreté par la proportion de pauvre dans la population totale. Il est par conséquent fondé sur le déficit de revenu global des pauvres par rapport au seuil de pauvreté et sur la proportion de pauvres dans la population considérée. Il renseigne sur la profondeur de la pauvreté puisqu'il dépend de l'écart entre le revenu des pauvres et le seuil de pauvreté. Il permet également de déterminer le montant nécessaire à l'éradication de la pauvreté. Son principal inconvénient réside dans le fait qu'il ne permet pas de décrire la sévérité de la pauvreté. Il est insensible à des transferts intra-pauvres.

- l'indice de sévérité de la pauvreté permet de prendre en compte les phénomènes de distribution inégalitaire des richesses au sein de la population pauvre. Il est difficile à interpréter ; mais son principal apport réside dans le fait qu'il est sensible à une modification de la distribution des richesses au sein des pauvres. En outre sa sensibilité aux transferts est plus forte quant ces transferts vont aux plus pauvres.

EAGER / PSGE

LA POLITIQUE FISCALE EN AFRIQUE SUBSAHARIENNE: UN NOUVEL EXAMEN DU ROLE DES DROITS D'ACCISES

Pays étudié : Madagascar

Principaux résultats d'une analyse statistique et économétrique

janvier 1998

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I - CALCUL DU « BUOYANCY » ET DES ELASTICITES DES DROITS D'ACCISES:

L'une des hypothèse du projet est que les « recettes provenant des droits d'accises peuvent et doivent doubler dans la plupart des pays d'afrique ». C'est dans une telle perspective que sont calculés ci-après « le tax buoyancy » et les élasticités des droits d'accises à Madagascar.

1- Calcul du buoyancy du total des recettes accises:

En calculant l'élasticité globale des recettes fiscales totales par rapport aux PIB par la méthode des regressions linéaires simples pour la période allant de 1978 à 1996 et en utilisant la méthode d'estimation « moindre carré ordinaire ou mco » :

GDP = PIB ou produit intérieur brut en milliard de FMG,
RF = recettes fiscales sans dons en milliard de FMG,
Année = année concernée.

Log (GDP) = -144,88 + 0,0746*Année $R^2 = 0,98$

Log (RF) = -119,74 + 0,0614*Année $R^2 = 0,95$

Période= 1978-1996

L'élasticité globale (B) est donc: B = 0,0614/0,0746 = 0,823 = 82.3%

Comme 0 < B <= 1, l'élasticité des recettes fiscales à la croissance économique lue à travers le PIB est quasi inélastique au cours du temps.

En remplaçant les recettes fiscales totales par les recettes issues des droits d'accises seulement (RA), l'estimation par la même méthode du modèle liant la variable « droits d'accises » en fonction du temps. et pour la même période donne:

Log (RA) = -247,7 + 0,1265*Année $R^2 = 0,90$

La nouvelle valeur de B devient 0,1265/0,0746 = 1,695 = 169.5 % et on constate que B = 169.5 % est supérieur à 1 , donc l'élasticité des recettes provenant des droits d'accises est en général élastique . Il apparaît donc que le « buoyancy des RA» (1,695) est supérieur au « buoyancy des RF » (0,823). Il semble que dans le contexte de la baisse tendentielle de la performance fiscale à Madagascar (taux de pression fiscale passant de 14 % du PIB en 1987 à 8 à 9 % en 1996), les RA dont le recouvrement est relativement plus facile se sont mieux comportées que l'ensemble des RF.

2- Calcul du buoyancy et des élasticités des droits d'accises spécifique:

Les « buoyancy » de la TUPP (taxes uniques sur les produits petroliers) ont été calculés selon la méthode de regression, avec les résultats suivants:

PRODUITS	Buoyancy
Essence tourisme	0,952
Gas-oil	2,099
Petrole lampant	-

Ces résultats montrent que les « buoyancy » des taxes sur les produits petroliers sont supérieurs au « buoyancy » des recettes accises totales (RA). En particulier le « buoyancy » de la taxe sur les gas-oil est supérieur à 2.

Pour affiner, les élasticités de ces taxes (TUPP) et celles des taxes rattachées aux bières et cigarettes ont été calculées avec les résultats suivants:

PRODUITS	ELASTICITES
Essence tourisme	0,038
Gas-oil	0,038
Butane	0,038
Bière	-0,115
Cigarette	-0,115

Il s'avère donc que si le calcul des « buoyancy » de la TUPP avait donné des résultats positifs, l'élasticité de cette taxe est quasiment peu significative. Les élasticités des taxes sur la bière et la cigarette sont non seulement faibles mais négatives.

C'est à partir de ces différents résultats que l'on déterminera plus tard si les recettes acccises peuvent être doublées à Madagascar, en vue d'améliorer la performance fiscale.

II- TUPP ET FUEL DEPENDANCY DE LA STABILITE MACROECONOMIQUE:

Le tableau ci-dessous permet de faire ressortir l'évolution suivante : Au début des années 80, les produits de la TUPP representaient 0.8 à 3.4% des Recettes et Dons, 1 à 4% des Recettes fiscales, et 2.5 à 9% des produits des Taxes sur biens et services ; en 1995 et 1996 les pourcentages correspondants étaient respectivement de 6.7 à 10.5%, 7 à 11.7%, et 26.4 à 47.3%. Dans le même temps, les Taxes sur biens et services ne representaient plus, en 1996, que 22.4% des Recettes et Dons et 24.7% des Recettes fiscales, contre, respectivement 33.4% et 40.9%, au début des années 80.

Cette évolution se caractérise donc par une baisse du rendement relatif des Taxes sur biens et services, sauf la TUPP. Elle doit être comprise, en fait, dans le contexte d'une baisse généralisée de la performance fiscale à Madagascar, où le taux de prelevement est passé de 14.6% en 1987 à 8.4% en 1995[1].

Aussi, en attendant une amélioration significative de cette performance fiscale, les taux de la TUPP sont, dans les accords de "stabilisation" avec le FMI, largement manipulés en vue du respect des critères de maitrise du déficit budgétaire.

	1981	1982	1990	1991	1992	1993	1994	1995	1996
Total des Recettes & Dons	142,7	145,9	611,2	456	608	687	796	1180	1521
Total des Recettes	142,7	145,9	465,7	354	504	557	749	1149	1405
Recettes Courantes	123,3	131,3							
Recettes Fiscales	116,4	126,6	434,3	336	484	527	702	1121	1375
Taxes s/ biens et services:	47,6	54,7	102,5	81,4	153	143	202	298,7	340
Droits D'Accises percue à l'import(TUPP)	1,2	5	5,1	8,4	36,1	58,1	19,1	78,9	161
en % de R et D									
Taxes s/ biens et services:	33,4	37,5	16,8	17,9	25,1	20,8	25,3	25,3	22,4
Droits D'Accises percue à l'import (TUPP)	0,8	3,4	0,8	1,8	5,9	8,5	2,4	6,7	10,6
en % de RF									
Taxes s/ biens et services:	40,9	43,2	23,6	24,2	31,6	27,1	28,7	26,6	24,7
Droits D'Accises percue à l'import (TUPP)	1,0	3,9	1,2	2,5	7,5	11,0	2,7	7,0	11,7
en % des Taxes/biens et services									
Droits D'Accises percue à l'import (TUPP)	2,5	9,1	5,0	10,3	23,6	40,7	9,5	26,4	47,3

Source : STA, Madagascar, 1997.

III- ESTIMATION ADEQUATE DES DROITS D'ACCISES EN TENANT COMPTE DES COUTS EXTERNES:

[1] Les causes et les aspects de cette contre-performance sont analysés dans le projet "Amélioration de la transparence de l'Administration fiscale"

1- Les taxes Uniques sur les Produits Petroliers (TUPF) et les coûts de l'entretien routier

La démarche qui consiste à mettre en relation la TUPP et les coûts d'entretien du reseau routier est, justement, celle d'une étude financée par l'Union européenne, en vue de la création d'un Fonds d'entretien routier (FER). Cette étude se base essentiellement sur les données de 1996 et projette les données de la TUPP et des coûts d'entretien routier pour 9 ans: de 1997 à 2005. Les projections du produit de la TUPP ont été calculéés à partir de l'évolution du PIB ; du secteur des transports, compte tenu de ses relations avec le PIB et de la consommation correspondante de carburant. A cela s'ajoute les élasticité-prix de la demande des différentes catégories de carburant.
A noter que les taux unitaires de la TUPP utilisés sont donc ceux de 1996.

Les projections en matière de budgets d'entretien routier ont été basées sur les besoins d'entretien du reseau et sur la capacité de réalisation des travaux d'entretien.

Le graphique suivant compare les resultats de ces deux projections :

En maintenant de façon constante les niveaux et la structure de la TUPP de 1996 d'une période à une autre, les résultats de l'étude tendent donc à montrer que, les dépenses d'entretien du reseau routier seront amplement financées de 1997 à 1999. L 'évolution prévisionnelle des recettes en TUPP et des dépenses d'entretien routier est presque tangente. Les deux variables coincident en 1998 et en 2005.

2 -TUPP et "pollution brune"

A cet égard, on se rapporte aux résultats des mesures réalisées par l'Institut national des sciences et techniques nucléaires (ISTN à Antananarivo) sur la pollution atmosphérique urbaine à Antananarivo[2].
Le taux des particules polluantes a été mesuré, par "Fluorescence X", dans les grandes axes de circulation de voiture de la capitale. En ce qui concerne l'origine des particules, il a été procédé à l'analyse de la teneur des ces élements dans le carburant distribué par la SOLIMA (Société unique et locale de distribution de produits petroliers à Madagascar) . Cette analyse a donné les valeurs suivantes pour le plomb et le brome :

	Essence	Super	Gas oil
Plomb	145 ppm	285 ppm	4 ppm
Brome	45 ppm	89 ppm	0 ppm

De ces mesures, on peut déduire que le Gas oil est le moins polluant, et qu'une voiture utilisant le super pollue 2 fois plus qu'une autre utilisant l'essence ordinaire. Vue sous l'angle de la "pollution brune", la structure actuelle de la TUPP à Madagascar est donc fondée puisque le volume des gaz-oils utilisés annuellement à madagascar est relativement supérieur au volume de l'essence et du super . Cette conclusion est illustré par l'évolution en volume de consommation de produits petroliers à Madagascar.

Tableau de répartition annuel et en volume (M3) de la consommation de carburant à Madagascar

[2] Mesure de la pollution atmosphérique urbaine à Antananarivo et recherche de son origine-ISTN-Communication au Deuxième Congrès malgache de la route-Mars 1997

Année	Essence super	Essence tourisme	Gas-oil
1978	5120	111813	159146
1979	4799	93973	183492
1980	3144	107997	184878
1981	2688	92547	169865
1982	1530	77671	149055
1983	2236	76454	147354
1984	2488	70867	146541
1985	2199	72672	150617
1986	2627	75260	167900
1987	2321	73396	165902
1988	2534	69107	163649
1989	2616	72488	178934
1990	4021	75788	193188
1991	3457	67448	194599
1992	4296	74002	217107
1993	6572	82658	219442
1994	3709	87338	250550
1995	3623	95893	260822
1996	5555	103503	257906

Source: SOLIMA, Madagascar, 1997.

3- TUPP et consommation de bois-charbon et déforestation

On s'interesse, ici, aux incidences éventuelles des niveaux des taux de la TUPP sur la consommation de charbon de bois et de bois de feu. Pour cela, on va utiliser un modèle linéaire pour essayer d'une part de déterminer les facteurs ou varibales qui exercent une grand influence sur le mode de consommation de charbon et de bois de feu en général et en particulier les impacts des taux de la TUPP sur la dite consommation .

MODELE

Le modèle linéaire a la forme suivante:

$Y = f(X, A)$ où

Y est le niveau de consommation en m3 de charbon de bois

X est le vecteur des variables explicatives composées de la TUPP sur le pétrole lampant

(PL), du prix nominal du petrole lampant à la pompe; du prix nominal du charbon de bois, de la croissance démographique, du taux d'inflation et PIB nominal considéré comme étant l'indicateur rapproché du revenu; et A est le vecteur des paramètres à estimer.

METHODE D'ESTIMATION

Comme il s'agit d'un modèle général linéaire, la méthode d'estimation utilisée sera la méthode du moindre carrée ordinaire (MCO). La qualité du modèle sera jugée en fonction de la significativité des paramètres, de l'importance du lien entre la consommation de charbon ou de bois de feu et les autres variables indépendantes et de l'absence de corrélation entre les différentes variables indépendantes.

LES DONNEES UTILISEES

Les données utilisées pour l'estimation des paramètres par cette méthode de MCO sont des données annuelles pour deux raisons principales: les données disponibles sont des données annuelles et l'utilisation des données mensuelles risque d'être entachée d'une grande erreur liée à l'effet de saisonnalité et donc à l'apparition d'une autocorrélation des résidus.

LES RESULTATS DE L'ESTIMATION DU MODELE

A cet effet, on examine, en premier lieu, la corrélation entre la TUPP sur le petrole lampant (PL) et la consommation de charbon de bois par les ménages urbains. La période choisie est celle allant de 1980 à 1989, celle pour laquelle on dispose de données fiables sur la consommation de charbon et de bois de feu.
La regression multiple integre les autres variables suivants :

- Le prix du PL à la pompe ;
- Le prix du charbon de bois ;
- La croissance démographique ;
- Le revenu, l'indicateur retenu étant le PIB réel.

Ces resultats tendent à montrer que, au cours de la période considérée, la consommation de charbon a été correlée à la croissance démographique, et pas du tout à la TUPP, ni même au prix du PL à la pompe. Il serait intéressant de prolonger cette analyse, lorsque des données fiables seront disponibles, en integrant les années 90, années marquées par une importante depréciation du FMG et des hausses sensibles de la TUPP.

Variables	*Coefficients*	*Ecart-type*	*Statistique T*	*Probabilité*
X 1 : tupp	-0.008	0.037	-0.215	0.843

X 2 : prix PL	-0.024	0.081	-0.299	0.784
X 3 : prix charbon	-0.003	0.055	-0.068	0.949
X 4 : population	1.815	0.485	3.740	0.033
X 5 : PIB réel(revenu)	0.413	0.246	1.676	0.192

Statistiques de la régression	
Coefficient de détermination multiple	0.99
Coefficient de détermination R^2	0.99
Coefficient de détermination R^2 ajusté	0.98
Ecart-type	0.012
Observations	9

ANALYSE DE LA VARIANCE

	Degré de liberté	*Somme des carrés*	*Moyenne des carrés*	*F*	*Valeur critique de F*
Regression	5	0,092	0,018	117,186	0,001
Residual	3	0,000	0,000		
Total	8	0,092			

4- Etude de l'effet de l'impact des droits d'accises sur la consommation d'alcool :

Pour étudier la relation qui peut subsister entre les droits d'accises et la consommation d'alcool, on fait appel à un modèle linéaire où la variable à expliquer sera la consommation d'alcool. Le modèle sera un modèle en logaritme népérien afin de mesurer l'élasticité de l'impact.

MODELE

VOLUME ALCOOL = f(PIB réel ,Taux accise/alcool, Prix de l'alcool);

Le volume de cigarette consommée représente la variable à expliquer consommation de tabac, les variables explicatives sont donc: les taux des droits d'accises, le PIB réel et le prix (le prix du rhum étant prix comme prix de référence)

DONNEES ET ESTIMATION

Les données utilisées pour l'estimation sont des données annuelles. La durée de la période d'estimation sera de 10 ans. La méthode de MCO sera utilisée et la consommation d'alcool est estmée à partir de la quantité de vente annuelle d'alcool.

RESULTATS

Statistiques de la régression	
Coefficient de détermination multiple	0,95
Coefficient de détermination R^2	0,91
Coefficient de détermination R^2 ajusté	0,86
Ecart-type	0,22
Observations	9

	Degré de liberté	*Somme des carrés*	*Moyenne des carrés*	*F*	*Valeur critique de F*
Régression	3	2,71	0,90	19,25	0,002
Résidus	6	0,28	0,05		
Total	9	3,00			

	Coefficients	*Ecart-type*	*T Student*	*Probabilité*
Constante	1,87	7,51	0,25	0,81
PIB	3,18	2,14	1,49	0,19
Taux accise alcool	-1,02	0,18	-5,56	0,00
Prix alcool	0,23	0,18	1,31	0,24

Dans l'ensemble, les coefficients de détermination ne sont pas trop loin de l'unité, y compris le coefficient ajusté. Le seul coefficient significatif est l'élasticité de la consommation d'alcool par rapport au taux de droit d'accises sur l'alcool. Par contre la significativité globale de chaque coefficient est assurée par le test sur la valeur de F calculée qui est toujours supérieure à F théorique. Il y a un effet négatif du droit d'accises sur le niveau de la consommation d'alcool alors que le prix du rhum ne semble pas avoir exercé un effet significatif sur cette consommation. L'élasticité de la consommation du rhum par rapport au PIB réel est supérieur à 1. L'alcool semble être un bien inférieur dans l'article de consommation courante.

5- Etude de l'effet de l'impact des droits d'accises sur la consommation du tabac :

Pour étudier le lien entre les droits d'accises et la consommation du tabc, on va recourir à un modèle linéaire où la variable à expliquer sera la consommation de tabac. Le modèle sera un modèle en logaritnme népérien afin de mesurer l'élasticité de l'impact.

MODELE

VOLUME CIGARETTE = f(Prix du cigarette ,Taux accise, PIB réel)

Le volume de cigarette consommée représente la variable à expliquer consommation de tabc, les variables explicatives sont donc: les taux des droits d'accises, le PIB réel et le prix des cigarettes. (le prix utilisé étant la cigarette dit « Melia »).

DONNEES ET ESTIMATION

Les données utilisées pour l'estimation sont des données annuelles. La disponibilité de certaines séries de données fait que l'estimation par la méthode de moindre carré ordinaire va porter sur une péruiode de 12 ans. La variable consommation de tabac est approximée par le volume de cigarette vendue annuellement.

RESULTATS

Statistiques de la régression	
Coefficient de détermination multiple	0.91
Coefficient de détermination R^2	0.82
Coefficient de détermination R^2	0.74
Ecart-type	0.27
Observations	10.00

ANALYSE DE

	Degré de liberté	*Somme des carrés*	*F*	*Valeur critique de F*
Régression	3	2.06	9.42	0.01
Résidus	6	0.44		
Total	9	2.50		

	Coefficients	*Ecart-type*	*Statistique t*	*Probabilité*

Constante	3.56	8.66	0.41	0.70
Prix cigarette	-0.01	0.27	-0.02	0.98
Taux accise	0.61	0.24	2.53	0.04
PIB réel	1.19	2.49	0.48	0.65

Les niveaux du rapport de détermination et du rapport de détermination ajusté indiqu'il existe une relation étroite entre le niveau de consommation et les autres varaibles explicatives. Quant à la question de significativité des coefficients, seul le PIB réel a de coefficient largement différents de zéro. Les autres paramètres avoisinent la valeur nulle. Globalement, la significativité de tous les paramètres est acceptable. La cigarette peut être considérée comme un bien normal (élasticité proche de 1).

La valeur positive de la constante peut traduire une situation de demande et de consommation indépendante de ces variables explicatives. Le prix de cigarette a un effet négatif sur le comportement de consommation de cigarette. En revanche, le taux du droit d'accises a une élasticité positive par rapport à la consommation de cigarette.

6- TUPP et Effets distributionnels

Les courbes de Lorenz construites à partir des données de l'Enquête Permanente auprès des Ménages (EPM, Madagascar) par Steve Younger et al. dans « Fiscal Incidence » montrent que la TUPP sur l'essence et le gasoil sont des impôts progressifs tandis que la TUPP sur le petrole lampant est regressive. Les auteurs sont étonnés par ces résultats, pour les deux raisons suivantes : le coefficient de Gini est élevé à Madagascar (haut degré de concentration des revenus) ; les impôts indirects sont généralement regressifs (exemple: le Ghana).

IV- TUPP SUR LE GAS-OIL EN TANT QUE POURCENTAGE DU PRIX DES AUTOBUS, COMPOSANTE DU COUT DE LA VIE ET POURCENTAGE DU PRIX DES TRANSPORTS:

1- TUPP en tant que pourcentage du prix des autobus et du coût de la vie

Pour pouvoir répondre à cette question, on s'appuye sur le tableau relatif aux structures des coûts d'exploitation des vehicules (CEV), conçus par les experts du Ministère de Transport malgache, publié une fois en 1996 et reste encore officiellement en vigueur dans le territoire malgache. Dépuis cette période il n'y a plus de mise à jour mais en sachant l'évolution de l'indice des prix on peut quand même étendre l'analyse. Le présent résultat se cantonne tout simplement d'une part à montrer l'existence du lien entre la TUPP et les prix des autobus et d'autre part à mesurer pour l'année considérée l'intensité de la liaison.

Le carburant representait, donc, 12.45 % du CEV d'un autocar ; or, en 1996, la TUPP representait 22.84 % du prix du gasoil , et le prix du bus 3.14 % de l'IPC (indice des prix à la consommation) ; il s'en suivrait que la TUPP sur le gasoil (consommé par les autobus) representait 0.089 % de l'IPC.

Le tableau suivant montre la répartition du CEV par type de voiture en % et met en exergue l'importance des coûts de carburants et des pièces de rechange dans la formation du prix des services offerts par les différents types de voiture.

AVRIL 1996	VEHICULE LEGER	TAXIBE	CAMIONNETTE	AUTOCAR	CAMION	ENSEMBLE
CARBURANT	23,40	32,13	16,79	12,45	13,95	16,27
LUBRIFIANT	3,29	2,06	1,81	1,03	1,02	1,30
PNEUMATIQUE	3,74	4,13	11,28	8,84	13,05	16,19
PIECES DE RECHANGE	29,36	24,96	26,38	25,96	25,30	26,77
MAIN D'ŒUVRE	0,45	0,30	0,62	0,33	0,33	0,65
SALAIRE EQUIPAGE	0,00	0,70	0,69	0,43	0,39	0,31
AMORTISSEMENT	9,71	5,26	9,25	8,70	7,36	5,34
INTERET	14,07	9,35	16,43	18,48	15,15	10,55
ASSURANCE ET AUTRE	15,99	21,11	16,74	23,79	23,45	22,63
TOTAL	100,00	100,00	100,00	100,00	100,00	100,00

Source: Ministère de Transport, 1997.

2- <u>TUPP en tant que pourcentage du prix de transport:</u>

En suivant le même raisonnement que ci-dessus, et sachant que le carburant representait 13.95 % du CEV d'un camion, et le prix du transport des marchandises 8.02 % de l'IPC, on déduirait que la TUPP sur le gasoil (consommé par le transport des marchandises) representait 0.26 % de l'IPC.

Si on considère, à present, les paramètres suivants :

- la somme des pondérations des différentes catégories de transport (marchandises, bus, taxi, taxi brousse) dans l'IPC est de 13.93 % ;
- la structure "moyenne" des CEV (colonne "Ensemble articulé" du tableau ci-dessus) et l'hypothèse que ces catégories de transport n'ont consommé que du gasoil ;
- la pondération de l'essence-tourisme dans l'IPC est de 1.92 % :

On déduirait que la TUPP sur le gasoil et l'essence-tourisme representait 1.29 % de l'IPC, en 1996.

Cette faible pondération de la TUPP dans l'IPC semble contraster avec l'apprehension de l'opinion publique envers la manipulation à la hausse des taux de la TUPP.
En fait, la réalité peut être analysée de la manière suivante :

Dépuis une quinzaine d'années, le principal facteur de hausse des prix, à Madagascar, est la depréciation du FMG. Or dans la structure "moyenne" des CEV, le carburant, le lubrifiant, la pneumatique, les pièces de rechange et l'amortissement représentent 65.87 % des CEV. Ces composantes sont importées, et donc directement affectées par toute depréciation du FMG. Sans parler de l'assurance (22.63 % des CEV) qui est également ajustée en fonction de cette depréciation. En effet toute hausse des prix du carburant, entrainée principalement par les changements des cours du petrole brut et du FMG, et secondairement par la TUPP, est mis à profit par les transporteurs pour ajuster l'ensemble de leurs coûts. Ce qui peut donner l'illusion que la hausse est liée au carburant et à la TUPP .

Différentes enquêtes sectorielle et régionales ont montré que le marché du secteur du transport, à Madagascar, n'est pas concurrentiel.

V- EVALUATION DES OPINIONS PUBLIQUES:

Les résultats des focus group réalisés en milieux urbains et ruraux montrent que d'une part, les groupes ruraux et les groupes urbains pauvres (en majorité à Madagascar) ignorent totalement l'existence des impôts indirects et d'autre part, seuls les groupes urbains des classes moyennes et, sans doute, des classes aisées connaissent un peu l'existence des impôts indirects, souvent de façon plus ou moins précise. Certains membres de ces groupes en ont une perception négative : ce sont des impôts injustes

Les paysans producteurs (non seulement pour la consommation mais en même temps pour la vente) assurent que, depuis l'instauration et l'augmentation de la TUPP, leurs dépenses en frais de transport n'ont pas cessé d'augmenter . Ce constat concorde bien avec la dernière explication sur le lien entre la TUPP et le prix de transport: le % du TUPP dans le prix de transport est très faible et toute manipulation de la TUPP n'aura pas forcément des effets négatifs. C'est l'effetf psychologique conjuguée principalement avec la dépréciation de la monnaie malgache FMG qui est à l'origine de la hausse des prix de transports.

EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH

Trade Regimes and Growth

Promoting the Competitiveness of Textiles and Clothing Manufacture in South Africa

Preliminary Report

Executive Summary

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January 29, 1998

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Promoting the Competitiveness of Textiles and Clothing Manufacture in South Africa[1]

Introduction

The present study focuses on a new opportunity for trade and investment in Africa, namely, in export-oriented textile and clothing sectors. Two issues, competitiveness and labor productivity, have been of particular focus in this study of South Africa's textile and clothing industries.

Both cost and non-cost factors are important determinants of a firm's competitiveness vis-à-vis international markets. Reorientation of South Africa's textile and clothing sectors toward export markets is underway as the country implements its trade liberalization commitments to the international community. Because of its labor-intensive nature, employment generation is an important benefit of the industry, particularly for female laborers who often comprise a large proportion of the manufacturing labor force. Thus this reorientation has important implications for labor productivity and the demand for labor in South Africa.

This preliminary report is being presented at the EAGER project workshop being held in South Africa February 4-6, 1998. It is very much a work in progress, and unresolved issues may be highlighted in the text. Clarifications and comments will be solicited from interested parties who have participated to date in the research. A presentation will also be made at the Clothing Federation's management committee meeting in February. Provincial associations and the SACTWU economist will be briefed as well. Their comments will be incorporated into a final version of the study which will be available by June, 1998.

Evolution of Textile and Apparel Production, Trade, and Regulation

Over time, as relative costs of labor and capital shift, textile and apparel manufacturing has moved from the U.S., Great Britain, and Japan, which dominated international trade of textiles and clothing in the first half of the 1900s, to lower cost countries. These global shifts were facilitated by a confluence of factors, including changes in economic policy of developing countries, the international division of labor, and the internationalization of capital.

As the success of new developing country textile and apparel exports took hold, textile and apparel interests in developed countries grew increasingly protectionist. Under the Multi-Fibre Arrangement (MFA), operative from 1974 to 1994, textile and clothing importers established bilateral import quotas in individual product categories whenever a trading partner's exports to its market became threatening to domestic market interests. This system of regulated textile and apparel trade helped to spawn increased internationalisation of production of these very products.

Today, the MFA is dead and international textile and apparel trade is managed by the Agreement on Textiles and Clothing (ATC), signed as part of GATT 1994. The ATC lays out a process of liberalization of bilateral import quotas from 1994 through 2005.

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[1] This study has been undertaken as part of the *Equity and Growth through Economic Research (EAGER)/ Trade Regimes and Growth* project, an applied research, training, and policy advising project designed to integrate economists and other social scientists in the economic policy making process in Sub-Saharan Africa. The project, funded by the U.S. Agency for International Development, is currently active in seven Sub-Saharan African countries (Mali, Ghana, Uganda, Kenya, Tanzania, South Africa, and Madagascar).

At the same time that an international trade policy regime is phasing out import quotas, many countries are establishing regional preferential trade arrangements with neighboring or partner countries. In some instances, these are free trade agreements, in others they reflect outward processing traffic, whereby inputs manufactured in developed countries are processed into final product in lower wage developing countries. With respect to Sub-Saharan African (SSA) textile and clothing exports, the U.S. Congress is considering a free trade bill which would offer duty-free, quota-free access for SSA exporters to the U.S. market. Although heavily resisted by U.S. manufacturers in large part because of fears of transshipment of Asian goods through SSA, the bill is still on before Congress.

The rising importance of regional trade blocs notwithstanding, if all goes according to plan, the shape and dynamics of international textile and apparel production and trade will have changed significantly by 2005. Countries and individual textile and apparel industries are anticipating, preparing for, and beginning to adjust to the anticipated market and technological changes being felt all over the globe. These changes hold important implications for the competitiveness of firms everywhere and for the management and policy strategies pursued by firms and the governments that regulate their markets. This defines the set of challenges facing South African firms today.

Survey Findings

In order to gauge the state of preparedness of South African firms for these changes, the DTI, TextFed, CloFed, and SACTWU agreed to an EAGER study of the policy issues involved in promoting competitiveness of the industries. A research team comprised of two American and two South African researchers was constituted, and interviews were conducted in Gauteng, KwaZulu-Natal, and the Western Cape. As of January, 1998, this research team had interviewed 103 clothing and textiles firms. These firms represent a range of sizes, product types, locations, modernity of plant, labor relations, retail channels, and dependence on exports and imports. The majority of firms do both some design and manufacture, although several CMT operations and a few design houses are also included.

Firms can be classified according to several criteria, including size, type of output, location, degree of modernity of plant equipment and management, labor relations, relations with retailers, and degree of dependence on international markets.

It is important to note that there is not one route to success, and firms with almost any mix of the above characteristics can be successful. While more large firms are successful, there is wide variation within size categories. For large firms, the degree of success depends partly upon market segment but also on the way in which the factories are managed. Success in small firms depends upon knowledge of industry trends and upon investment, rather than upon low wages.

Here a tale of two companies is instructive. To keep confidentiality, these two firms are stylized and not entirely real. The stylized unsuccessful firm is a combination of the features of two large companies interviewed and the second a combination of features of five factories of three large clothing and textile firms (the full report describes stylized small firms as well). Thus no real firm exhibits all of the characteristics of the stylized firms, but the real firms are nonetheless very close to this composite picture.

One large company (company A) produces for the mass market, has little computerization of inventory, design or administrative functions, has not invested substantially in new machinery in South Africa, and quite explicitly views labor relations as purely a matter of discipline. A second large company (company B) has a more mixed market segment, ranging from up-market, relatively specialized products to more mass market items produced in long runs. This company also differs in its computerization of design and administrative functions and in labor relations. Moreover, this

company is informed of and experimental in implementing modern methods of organization like just-in-time inventory control and flexible methods of moving work along the line. This company also has a policy of promoting through the ranks and of training for multi-skilling and multi-tasking. It rewards workers for suggestions that save money and it has a bonus scheme that increases the bonus percent as workers get closer to the target.

The first company, company A, has fallen on hard times and has downsized, with the ultimate goal of moving production out of the country all together. Company B is profitable and expanding. Although it has explored moving out of South Africa, it believes that there is plenty of opportunity to make money in South Africa and will stay.

The lessons from these two stylized firms are clear. While the first firm does have external conditions which are difficult, it has done little to respond creatively to the challenges. Its response is to continue to do what it has always done, only in a different location. It chooses locations which still look more like the South Africa in which it was for many years successful. The second firm, in contrast, is forward looking and flexible, changing its internal organization and strategy in response to changing external conditions.

The main conclusion about size of firm from the interviews is not that size does not matter. Economies of scale do offer certain opportunities denied to small firms, particularly with regard to investment in up-to-date technology. Size by itself, though, is not a substitute for the other factors highlighted above. Management education and spirit, the structure of the firm, and its labor relations swamp size as determinants of success. Market conditions obviously are important, but, as noted above, company A kinds of firms take the conditions as given, while company B firms try to change them.

Policy Implications

Policy implications of the interview information are beginning to emerge. They focus around the following themes:

- **Human capital development:** Central to firm performance is the education and skill levels of workers and managers. Government expenditures on basic literacy, adult education, and technikons will likely have the effect of "crowding in" private sector investment. Changing managerial behavior and attitudes is a more subtle problem.

- **Access to capital:** Access to working capital is a second critical area, particularly if government is concerned with growing small firms. Something as simple as bridging finance for established CMT operations can help set into motion the virtuous cycle of avoiding slack time, having a more stable work force, and achieving higher quality and productivity. Investment capital is expensive in South Africa, with rates in excess of 20%, compared with international rates below 10% in the U.S. and Europe. This clearly constrains the enthusiasm of investors in new capital equipment in South Africa. With regard to capital as technology, while other countries enjoy public-private research in the development of applied technologies to further the competitiveness of their textile and clothing sectors, we have found little evidence of this in South Africa.

- **Policy stability:** Clear, medium-term policy parameters should be established to minimize uncertainty about the macro, labor, and sectoral policy environments which greatly complicates firms' strategic planning. While it is not necessarily the case that policy stability will overcome inherent risk-aversion in managers of company A firms, it will in any case be good as well for the more risk-taking firms. With broad changes in government now settled in South Africa, the

private sector needs some assurances of stable, or at least predictable, exchange rates, interest rates, inflation rates, wage rates, tariff rates, and so forth.

- **Export promotion:** This study revealed sparse use by firms of DTI support for trade-related travel. Programs to help firms become aware of and use the available export marketing assistance would be helpful to export initiatives.

Several notes of caution are in order. The first is with respect to the underlying assumption in South Africa of pipeline cohesion among textile and clothing firms. For analytic purposes, this view is appropriate. However, from a management or firm strategy perspective, there is nothing which necessarily binds these two subsectors together. As they do abroad, firms in South Africa at all levels of the pipeline must be encouraged to compete.

The other caution is with respect to the informal end of the clothing sector. This segment of the pipeline is the safety valve of the sector. The temptation to the CMT firm owner, because of his/her firm's smaller size in many instances, is to avoid compliance with wage guidelines of the Industrial Councils. The temptation to the government and union is to see this as a flouting of economic principle, and to enforce new Wage Board guidelines. It is suggested here that in the interests of job creation, zealousness be moderated cautiously.

In conclusion at this stage, there is every evidence that many South African firms are learning to compete. While firms may complain of policy instability, one clear policy message is definitely getting through. This is that South Africa, having rejoined "the family of nations" on the political front, intends to integrate its economy and its body of economic regulation with international standards as well.

While the degree of tariff reduction currently anticipated is still quite protective (effective protection, despite firms being taxed on tradable inputs, is well over 100% due to heavy nominal protection on outputs), South African firms understand that liberalization is the wave of the future, and are reacting to it in various ways. Some are quite concerned and fear they will not survive, others are taking the necessary training, reorganization, and modernization steps to prepare not just to react but even to shape their own futures within South Africa and on international markets. For those firms seeking assistance in export market penetration, several government programs now offer resources in a spirit of partnership with the sector.

Thus, there is considerable optimism in the industry today that collaborative efforts are beginning to yield an export strategy that will be good for business in South Africa. To the extent that the message of the link between progressive use of labor by management and improved productivity and competitiveness can be communicated widely, then there is some real hope that labor may share in the gains of export orientation as well.

RELANCE DE LA CROISSANCE ET DEVELOPPEMENT DURABLE EN AFRIQUE

ETUDE DE CAS : *LE SENEGAL*

CADRE DE L'ETUDE – (DECEMBRE 1997)

A- OBJET GENERAL

L'objectif de l'étude est triple :

1- Identifier les principaux facteurs politiques, économiques et sociaux qui empêchent le Sénégal d'accéder à une croissance économique rapide définie comme la réalisation, de manière durable, d'un taux de croissance du PIB supérieur à 6 %.

2- proposer de manière concrète, les voies et moyens permettant de surmonter ces obstacles.

3- Produire un document final en proposant les dispositions à prendre pour diffuser les résultats de la recherche dans une phase ultérieure du projet.

B- HISTORIQUE

De nombreuses études initiées par le FMI, la Banque Mondiale, les différents bailleurs de fonds, ainsi que les institutions et les chercheurs sénégalais ont analysé maints aspects de l'économie sénégalaise. Plusieurs de ces études ont évalué les obstacles à l'investissement, à la création d'emplois, à la promotion de la productivité et des exportations, proposé des mesures permettant de réduire et d'éliminer ces obstacles.

Parmi les plus récentes et les plus importantes de ces études on peut retenir:
1- le dernier rapport de consultation (Art IV) du FMI
2- le dernier rapport de la Banque Mondiale
3- Le rapport d'Eliot Berg (Avril 1997)
4- Diverses études du CREA
5- D'autres études à identifier

C- STRATEGIE DE RECHERCHE

La présente étude débutera par une revue critique de la littérature précédemment identifiée qui résume les principales recommandations de politique économique. En partant de (i) la revue de la littérature, (ii) l'analyse des données récentes, (iii) les nouvelles analyses réalisées, l'étude couvrira 5 principaux thèmes.

1- la définition des éléments clés de la stratégies économique qui, selon l'équipe de recherche, est capable de relancer la croissance et le développement au Sénégal.

2- L'identification de la stratégie économique menée actuellement par le gouvernement en termes à la fois (i) de stratégie déclarée et souhaitée et (ii) de degré d'application.

3- L'identification des éléments de la stratégie définie au point 1 qui sont absents des programmes et de l'action du gouvernement identifiés au point 2.

4- L'analyse des obstacles à l'introduction des éléments actuellement absents identifiés au point 3 ; et

5- les propositions pour surmonter ces obstacles et relancer la croissance.

D- MISE EN CHARGE

L'étude ne devra pas s'égarer dans l'examen détaillé des analyses et des recommandations contenues dans les documents existents. Son objectif est de faire ressortir les principaux obstacles à la gestion macroéconomique du pays et de recommander les voies pour les surmonter.

E- ASPECTS RELATIFS AUX EXPORTATIONS COMME MOTEUR DE LA CROISSANCE

La plus part des analyses portant sur le développement économique du Sénégal, qu'elles soient menées par des chercheurs nationaux ou étrangers, ont constamment conclu :

1- que l'économie ne pouvait accéder à une croissance rapide sans que certains secteurs, parmi lesquels l'industrie manufacturière, le tourisme et autres services, réalisent un taux de croissance supérieur de plusieurs points au taux de croissance du PIB ;

2- que la demande intérieure ne pouvait pas absorber le niveau d'output acquis pour assurer une croissance convenable. Ce qui implique que les exportations sénégalaises de biens et services doivent croître encore plus rapidement ;

3- que l'accés aux marchés d'exportation exige un niveau élevé d'éfficacité et de productivité ce qui signifie , en d'autres termes, que les industriels sénégalais et les autres producteurs de biens exportables doivent obtenir des inputs à des prix ne dépassant pas les prix mondiaux.

Par conséquent, l'étude accordera une attention particulière aux obstacles qui ont (i) limité la croissance du produit du secteur manufacturier à 3,7 % par an sur la période 1980-1995 (ii) contenu le même secteur à un quart des exportations totales actuelles (BIRD, World Development Indicators 1997) (iii) limité dans le même temps la croissance et les possibilités d'exportations des secteurs qui ont joué un rôle primordial dans la croissance économique très rapide des pays d'Asie et d'autres régions du monde et (iv) freiné l'accés aux marchés de l'UEMOA et des autres unions régionales pour les produits sénégalais.

F- TAUX DE CHANGE

En raison de ses effets répressifs, la surévaluation jusqu'en 1994 a été analysée de façon approfondie par une documentation abondante. L'étude ne reviendra pas sur ces analyses. Elle passera cependant en vue les signes les plus récents de l'impact de la dévaluation de Janvier 1994 en évaluant dans quelle mesure la dévaluation a crée les incitations indispensables à la croissance de l'investissement, de l'emploi, de la production et des exportations. L'étude s'intéressera aussi à l'impact du taux de change fixe sur la compétitivité de l'économie sénégalaise, et si cet impact s'avère négatif, elle indiquera les différents choix, elle considérera la possibilité de persuader les autorité de l'UEMOA d' effectuer un ajustement graduel du taux de change en réponse aux signaux du marché.

G- CONDUITE DES REFORMES ECONOMIQUES

L'étude résumera les principales étapes de l'adoption, de l'implantation et de l'interruption des réformes économiques au Sénégal. Elle identifiera les facteurs qui ont jusqu'ici bloqué la croissance, elle s'attache a mettre l'accent sur circonstances dans lesquelles les réformes favorables à la croissance telles celles liées à la libéralisation ont été approuvées, commencées et plus tard considérablement ralenties et ou abandonnées.

Le rapport évaluera les influences des différentes parties prenantes - communauté des affaires, groupes politiques, bailleurs de fonds dans l'engagement et pour l'interruption des changements. Il évaluera également les motivations du gouvernement dans l'adoption et la suspension des réformes.

H- OBSTACLES ECONOMIQUES, INSTITUTIONNELS ET POLITIQUES AUX REFORMES

Parmis les obstacles aux réformes identifiés au paragraphe G, l'étude s'attachera particulièrement à analyser ceux qui suivent :

1- Les actions menées par les bénéficiaires des situations de rente créées par l'intervention de l'Etat dans l'économie pour les conserver.
2- L'exploitation des pouvoirs de monopole/oligopole par les intérêts commerciaux liés aux fournisseurs étrangers conduisant à des coûts de production sénégalais élevés et faisant obstacle à l'intégration du Sénégal dans l'économie mondiale.
3- Les distorsions dans les procédures instituées par le gouvernement pour assurer l'approbation des investissements étrangers à un guichet unique.
4- Le maintien du contrôle par les agents de l'Etat, de fonctions dévolues aux collectivités locales ce qui contrecarre les efforts du gouvernement dans la mobilisation des initiatives locales par la décentralisation.
5- La mesure dans laquelle le cycle électoral, parce que le gouvernement protégerait les avantages acquis de groupes électoraux et de grands bailleurs électoraux, a retardé les réformes.

I- ENQUETE AUPRES DES INDUSTRIELS ET PRODUCTEURS DE SERVICES

L'étude passera en revue les témoignages fournis par les industriels, les commerçants et les producteurs d'autres services (à la fois pour la consommation finale et pour servir d'inputs aux industries tels les transports et les télécommunications) sur les sources de l'insuffisance et de la faible productivité ainsi que sur les facteurs découragent l'investissement, l'emploi, la production et les exportations. Ces obstacles incluront ceux identifiés ci-dessus (H). Une attention particulière sera accordée aux obstacles créés par la bureaucratie gouvernementale comme la corruption, les tracasseries et les retards dans l'octroi des subventions. Dans cette optique les chercheurs conduiront des enquêtes auprès des dirigeants et des membres importants d'organisations tels que :
1- Le Conseil National du Patronat
2- Le Conseil National des Employeurs du Sénégal
3- Le Syndicat des Patrons d'Industries du Sénégal
4- Les Syndicats de travailleurs

Ces enquêtes inclueront des interviews structurées conduites par des chercheurs de haut niveau au lieu de demander aux enquêtés de remplir des questionnaires écrits.
Autant que possible, l'étude recueillera des témoignages indépendants pour apprécier la valeur des affirmations des sondés.

J- POSITION DES DECIDEURS

A travers les interviews d'observateurs de la scène politique sénégalaise et des décideurs (dans la mesure où l'accès est accordé) les chercheurs apprécieront et évalueront la perception qu'ont les décideurs sur les causes de la faiblesse de la croissance au Sénégal et sur les voies et moyens permettant de relancer la croissance. L'étude recherchera les réponses aux questions telles que :
1- Quelle est la vision des décideurs sur l'avenir du Sénégal ? Pensent-ils sérieusement que le Sénégal peut réaliser des taux de croissance du PIB par tête comparables à ceux des pays émergeant d'Asie ?
2- Les décideurs sénégalais sont-ils conscients du fait qu'en 1962 le PNB par tête du Sénégal était supérieur de près de 30% à celui de Corée du sud, représentait 82% de celui de l'Ile Maurice et 62% de celui de la Malaisie et qu'en 1995 les 3 pays ont des PNB par habitant représentant respectivement 16, 6,5 et 5,6 fois celui du Sénégal ?

3- Quelle est la perception des décideurs (s'ils en ont une) sur (i) les sources de la croissance rapide des pays asiatiques et (ii) les raisons pour lesquelles le Sénégal a été incapable de réaliser une performance similaire ?

4- Quel rôle (le cas échéant) les décideurs sénégalais pensent-ils que les dirigeants politiques asiatiques ont joué dans la croissance industrielle et la promotion des exportations de leurs pays ? Jusqu'à quel point prétendent-ils s'évertuer à jouer un rôle comparable ?

5- Jusqu'à quel point les décideurs ont-ils pris conscience des recommandations des partenaires bilatéraux et multilatéraux et des économistes sénégalais de mener à terme le processus d'ajustement structurel et d'approfondir l'intégration du Sénégal dans l'économie mondiale, et quelle appréciation portent-ils sur ces suggestions ?

6- Par quels canaux les décideurs peuvent-ils prendre connaissance des obstacles de la conduite des affaires au Sénégal ? De quel segment de la communauté des hommes d'affaires sont-ils à l'écoute ?

7- Jusqu'à quel point les décideurs ont-ils conscience des récriminations des milieux d'affaires et des investisseurs étrangers sur les obstacles bureaucratiques à leurs activités, y compris les coûts élevés liés à l'exécution des contrats et aux autres appuis attendus du système juridique sénégalais ? Jusqu'à quelles limites pensent-ils s'efforcer à répondre à ces récriminations ?

8- Comment les décideurs estiment-ils leur propre responsabilité en tant qu'obstacles à l'application des recommandations vers une stratégie tournée vers l'extérieur qu'ils
approuvent ? Quelles influences attribuent-ils aux droits acquis (notamment de leurs adversaires politiques, des syndicats de travailleurs, hommes d'affaires) comparés aux influences des choix exogènes (climat, baisse des prix mondiaux, concurrence des économies asiatiques, etc) ?

9- Dans quelles orientations de politiques économiques les décideurs voient-ils les meilleures chances de lever les obstacles à une croissance rapide dans un avenir proche? Comment pensent-ils introduire ces orientations ?

10- Les décideurs sont-ils conscients des interrogations de l'étranger sur les produits sénégalais vis-à-vis desquels il éprouve un sentiment d'insatisfaction ? Pourquoi n'a-t-il pas été possible de répondre à ces frustrations ? Les décideurs ont-ils pris des mesures concrètes pour pousser la communauté sénégalaise des affaires à exporter ? Quels exemples peut-on donner?

11- Si les chercheurs estiment que les décideurs consacrent trop peu d'efforts et de temps à la promotion de la croissance économique quels sont les éléments à signaler à leur attention et quel serait le coût d'opportunité pour les décideurs d'une plus grande mobilisation pour la croissance ?

Sur la base de témoignages indépendants, l'étude évaluera les réponses des décideurs à ces questions et à d'autres.

K- CONCLUSIONS

Les chercheurs porteront un jugement sur les perspectives de croissance de l'économie sénégalaise si les tendances actuelles se maintiennent, et indiqueront quels efforts doivent être entrepris par les analystes et les bailleurs de fonds pour faciliter l'implantation des politiques et l'introduction des réformes. Parmi les mesures proposées il faudra définir un programme pour diffuser et défendre les conclusions de l'étude, y compris la distribution des résumés, l'organisation d'activité, etc.

L- RESULTATS DE L'ETUDE

L'étude produira au moins quatre documents :

1- Un programme de travail initial
2- Un rapport d'étape
3- Un rapport final provisoire
4- Un rapport final sous forme publiable

M - DIRECTION DE L'EQUIPE DE RECHERCHES

L'étude sera menée sous la direction d'une équipe de supervision comprenant des représentants du gouvernement sénégalais, du secteur privé et de la communauté académique.

Cette équipe se réunira au moins quatre fois :

- pour examiner et améliorer le cadre de l'étude
- pour déterminer le programme de travail initial, le rapport d'étape et le rapport final provisoire.

DRAFT 1/30/98

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Restarting and Sustaining Growth and Development in Africa: An Overview of the Institutional Dimension

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Restarting and Sustaining Growth and Development in Africa: An Overview of the Institutional Dimension

Arthur A. Goldsmith[1]

Introduction

Sub-Saharan Africa (SSA) is "on the move," reports Evangelos Calamitsis (1997: 201), Director of the International Monetary Fund's African Department. Callowest Madavo and Jean-Louis Sarbib (1997), the World Bank's Vice Presidents for Africa, make the same claim in the title of a recent article. After years of economic stagnation, output is growing at an accelerating pace in that region. Business confidence on the continent is growing correspondingly more buoyant. In answering several survey questions, African managers report their perception that important aspects of the business environment have improved recently. The respondents anticipate those business conditions are going to get even better in the next several years (World

Economic Forum 1998).

Averages can mask wide individual deviations, however, and this is true of Africa's economic performance. A few countries, notably Botswana and Mauritius, never suffered the fall-off that characterized SSA during the "lost decade" 1980-89. Others, such as Eritrea, Uganda, and Namibia, have been recovering since that time from the destruction of civil war. A third group of countries are sliding in the opposite direction in the 1990s toward chaos and economic collapse. Liberia, Sierra Leone, and Congo/Brazzaville are in the latter category. Sweeping statements about so diverse a set of national experiences are bound to inapplicable in some instances.

While it is imperative to avoid jumping to conclusions about any particular African country based on what happened in another, the region as a whole has suffered what Easterly and Levine (1995) aptly call a "growth tragedy." No comparable misfortune has befallen any other large part of the developing world. The official statistics are somber. Table 1 displays some of the more eye-catching data. The base year for comparison is 1980, chosen because it roughly marks the start of the contemporary period of experimentation with market-oriented development policies. The final year is 1995 (or the most recent year available). How much progress has SSA made during the intervening years? Africans who were poor on average are grown even poorer. Physical infrastructure has been neglected. Savings are down. Exports have dropped in value. Foreign debt is heavier than ever.

INSERT TABLE 1 ABOUT HERE

These data are hardly perfect, and informal sectors may have done better than the measured economies in many places. Furthermore, as mentioned above, some countries are outperforming the regional aggregate numbers, particularly since the mid-1990s. So, even if we assume the reported figures are accurate, any blanket description of SSA is not going to apply to all countries, all the time. Still, Table 1 depicts a continent in broad torpor. A few years of improved economic performance in a few countries do not nullify the bleak overall impression.

African governments, with the backing of multilateral organizations and bilateral donors, have responded to the crises by liberalizing and restructuring their economies. They have agreed in principle to limit their reach, via privatization of public activities, deregulation of national industries, and freeing of international trade. Progress has been slower than hoped, but the IMF (1997a) reports the pace of structural reform did pick up in SSA in 1986-95 compared with the previous decade. These policy changes presumably help account for the brightening economic outlook, though the recovery of world commodity prices is probably a more important factor.

The goal of the Restarting and Sustaining Growth and Development in Africa research project is to illuminate why that region is the graveyard of so many economic reforms. But perhaps a more fruitful way to look at this issue is to turn it on its head, and to try to interpret the modest improvements that have occurred. The odds are stacked against meaningful economic reform in Africa, yet positive steps are being taken in some countries. Our understanding of the reasons for success is thinner than

our understanding of failure, though success is often the better teacher.

The larger Restarting Growth study's principal focus is public policy—laws or rules that express collective goals and provide rewards and punishment to attain them. A major crosscutting theme of the project, and the heart of this paper, is the malfunction of institutions, defined as stable, recurring patterns of behavior. Much of Africa's recent history is marred by interest groups, political parties, elected officials, and public bureaucracies that accomplish little.[2] Yet, there are exceptions to the rule. Business associations, technocrats, and other organizations have been an impetus for reform in some countries. These constructive experiences have not been well documented.

Institutions, because they underlie policy making, help determine what policies are chosen and how they are executed. Where institutions are weak or ineffective, policy is likely to be the same. A public effort, say, to combat political corruption will not get far without an effective ombudsman, inspector general, or other office to carry it out. The effectiveness of such offices, in turn, will depend on factors such as the caliber of the personnel involved, the resources at their disposal, and the level of popular demand for their services. Public policies succeed or fail according to these sorts of institutional considerations.

Separating policy from institutions is, unfortunately, not simple in practice, for the two concepts overlay each other. While institutions are a constraint on policy, policy constrains institutions, too. Government often aims to alter institutions as a first step to reach other objectives. The drawback is that institutional changes usually lag policy

changes, which can foil any endeavor by officials to move to new common goals. There is particular irony in SSA, where recent economic reforms mean to diminish the role of government, yet they also thrust new demands on government to see these reforms through.

Government Failure

This new demand on the public sector raises the issue of government (or "nonmarket") failure—public policies and institutions that produce net social cost or loss (Wolf 1988: 37). Governments fail in two ways, which are commonly lumped together. Type 1 failures are to do things that government ought not do; type 2 failures are *not* to do things government should do (or to do them in such a substandard way that the effect is similar). The remedies to these two variants of government failure are distinct: the first requires restricting the state, the second requires strengthening it. Politically difficult as the first remedy is, getting out of the inappropriate areas is often easier compared with becoming adept at doing the right things.

Type 1 failures (the state overstepping its bounds) get top billing in what Williamson (1993) calls the "Washington consensus" on economic strategy. Seen from the eyes of the Washington consensus, the leading economic challenge in SSA (and in other regions, too) is that the state has grown too big and intervened too deeply in economic decisions, displacing the private sector where it could be more active. Excessive or

unfair taxes, trade barriers, and other counterproductive policies explain most of Africa's shortfalls compared with other developing areas (Sachs 1996)—though climate, demography, and other factors are important also (Sachs 1997). The Washington consensus has downplayed Type 2 failures (the state neglecting necessary tasks) until recently, though it is giving them more attention now (World Bank 1997c).

Since defects of government are manmade, human action can cure them. According to the Washington consensus, the antidote is easy to prescribe: reduce the scale of government, increase the role of markets, and integrate the domestic economy with the global marketplace. The resulting strategy has become known, somewhat loosely, as structural adjustment.[3] International donors usually help design and pay for this strategy in SSA, which they also have promoted in South America, the Caribbean, Asia, and eastern Europe. Parallel developments have been taking place since about 1980 within the advanced industrial countries, too.

Restructuring African Economies

Adjustment came to prominence in Africa with the publication of the World Bank's (1981) "Berg Report," as this official document is usually called, referring to its principal author. In the early years of adjustment, the international financial institutions were largely indifferent to type 2 failures. They took for granted government's positive

economic functions while they fought the type 1 failures of government excess. Ironically, though, the austerity measures associated with the neoliberal, orthodox economic strategy were apt to weaken the capacity of the state to be constructive (admittedly while also weakening the state's capacity for destructive behavior). Kahler (1990) labels this contradiction the "orthodox paradox." As North (1997: 8) expresses the same idea, "you can't do with the state but you can't do without it either." It may seem absurd to the casual observer, but after a period of seeking less government, many countries have found they need more government—though often for different tasks (Grindle 1997).

Structural adjustment was poorly received in Africa at first, for the restructuring measures spell political trouble for the governments that carry them out. Still, continuing with the status quo in the 1980s was economically untenable (though in many ways a defendable position in domestic political terms) for most of SSA. Due to their economic imbalances, the insolvent countries had to face a day of reckoning sometime. Not to change policies at all would have led to further downward spiraling of production and consumption.

Foreign aid was attractive to African leaders as a way to buy time and to ease the pain of economic reconfiguration—but perhaps also to have something to blame for the distress if things did not go according to plan. They may have seen the conditions of a structural adjustment loan as the last chance to spare themselves from having to make even more radical change (Gordon 1996). By 1993, 38 African countries (out of 48 in

the region) had agreed to at least one structural adjustment program with either the IMF or the World Bank; most had agreed to several (Kraaij 1994). Countries were rewarded for adopting the "right" policies with new funds, which could cushion the worst effects of foreign exchange shortages and indebtedness while they exposed their economies to the free play of market forces. Part of the price, however, was continued or deepened dependence on development assistance (the data are reported Table 1). National autonomy eroded, as the borrowing governments had to agree to dozens of provisos covering the full range of economic policy to get adjustment loans.

The international donors came under contradictory criticism for their role in adjustment. On the one hand, they stood accused of blackmailing SSA, of disregarding African sovereignty in key matters of public policy. The neoliberal policy recipe is unvarying—excise bureaucracy, liberate entrepreneurs, and allow the market to operate unhindered. When economies stagnated anyway, the donors' high profile made it easy to become the scapegoat, as for example when President Mugabe denounced the World Bank as a "dictator" in 1996, after the Bank had demanded a reduction in Zimbabwe's budget deficit. On the other hand, the donors also were faulted for being too lenient with their aid, for not wringing out more concessions even if that meant a government falling. Would Mobutu's "kleptocratic" regime in Zaire have lasted 32 years without external connivance? Whichever of these two lines of criticism comes closer to the truth, donor involvement in economic reform has colored SSA's policy making process without always improving the results.

Restarting and Sustaining Growth and Development

Today most African governments officially concede their typically statist approaches to development had been a mistake. At the same time, these governments frequently fail to implement the spirit (and the letter, too) of liberalization. The vacillating public attitude of Kenya's President Moi is emblematic. In March 1993, he rejected an IMF plan for being cruel and unrealistic. One month later he reversed himself, forced by economic reality to agree to the plan. In June 1997, the IMF cut off lending to Kenya after Moi refused to take aggressive steps to combat corruption. Again his initial reaction was defiance, swiftly followed by a more accommodating line.

The extent of policy slippage may seem remarkable in the face of heavy international pressure to push ahead with liberal economic reform. In a recent study of 26 SSA adjustment programs by the World Bank (1994), only six participating countries were classified as having "improved" their policies significantly. Among the small number of supposed improving countries, the Bank deemed that Ghana alone had an "adequate" policy environment, i.e., one in accord with the Bank's market-oriented precepts. The other five countries were judged fair or poor in policies, despite having made what the Bank claimed were large strides in reforming their economic practices. Deeds obviously speak louder than words in matters of economic policy. When it comes to relaxing controls on business and cutting back the public sector, African practice is too often less than proclaimed.

Controversies over Adjustment

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To some extent the obstructionism may be due to genuine disagreements about the gains of trade and unfettered markets. An often bitter dispute goes on over structural adjustment, though sometimes differences in semantics make issues more contentious than they need to be. The skeptical position about adjustment is often called the heterodox view of development policy (to distinguish it from the Washington orthodoxy). While it is too diverse to qualify as a school of thought, the heterodox view is prone to ascribe more of Africa's economic setbacks to market failures (significant deviations from the utopian world of perfect competition) than to overgrown government. It sees a greater role for the state in leading the way to development, in the manner of Germany and Japan in an earlier day or Taiwan and South Korea now. Among international organizations, UNICEF and UNECA look at matters through heterodox lenses. So do many African governments. A cynical interpretation, however, is that the latter see the world this way because it is a convenient way to justify their hold on power and to excuse their mistakes.

Markets fail whenever the "invisible hand" of competition produces effects that are harmful or unwanted, as opposed to the mutually satisfactory situation described by neoclassical economics. Market failures are far from rare in Africa. Heterodox critics make a good point when they say that obstacles in the region's economic structure (including geographical isolation, harsh climates, lack of natural resources, shortages of human capital, lack of economic diversification) impede market mechanisms even when government gets out of the way. They are also right to note that Africa's systems

of production and distribution are ill-prepared to cope with external shocks (rising oil prices, falling commodity prices, drought, and the like). From the heterodox perspective, therefore, the "withering away of the state" is, by itself, not going to allow resources to flow to their most productive uses in Africa.[4] The underlying structural barriers must be tackled as well, and that may require positive action by public authorities.

Still, few heterodox critics of adjustment would deny that African governments often try to do too much, and that they do many of those things poorly. It makes sense for the state to get out of such jobs, so it can concentrate on the things only it can do or that it can do best. The hard part, of course, is in agreeing on where the economic borders of the state should be drawn. As is often acknowledged, few examples of *laissez-faire* marketplaces exist in the world, mostly various degrees of mixed economies with different arrangements between the state and the private sector.

The State in Africa

The state is among the more sweeping terms in social science. It refers to a territorially-based, organized capacity for collective action, backed up, as Weber (1947) famously noted, by a claim to use legitimate force to ensure compliance. Generalizing about the several dozen African states must be done cautiously, but significant common features exist. This fact comes out best in a comparison with other regions.

Restarting and Sustaining Growth and Development

Most African states are young, with comparatively few years of formal independence. More noteworthy than the official date of independence is the age of the current regime. This figure is admittedly subjective and difficult to ascertain, but one attempt is shown in Table 2. It suggests the average regime in SSA is about 27 years old, somewhat younger than regimes in Asia and the Pacific or the Middle East and North Africa, and somewhat older than those in Western Hemisphere developing countries. African regimes also must cope with more heterogeneous societies than are the rule in the rest of the Third World (as shown by the higher average score on the ethnolinguistic diversity index.) The deeper and more fragmented ethnic fault lines in African countries probably make them harder to govern.

TABLE 2 ABOUT HERE

Their youth and diversity are often thought to render African governments unstable. From a comparative point of view, though, the evidence for instability is mixed. If we look at the average African chief executive's term in office, he has served more years than his Latin American or Asian counterparts (though fewer years than is typical in the Middle East). In fact, one problem in SSA has been the refusal of "dinosaur" rulers like Robert Mugabe or Daniel Arap Moi to step aside. When stability equals immobility it is not necessarily a virtue for a political system.

Another indicator of political instability are illegal challenges to the political leadership. How often do *coups d'etat* and revolutions happen? Any tally of such events is subject to error, due principally to underreporting in countries of less interest

to foreign media. With that caveat in mind, Table 2 reports that coups and revolutions affected about one African country in three during the 1970s and 1980s. That is comparable to the rate in Latin America, more than in Asia, and less than in the Middle East.

Efforts have been made to use the number of violent political events and other data to construct overall indexes of political instability. Three of them are reported in Table 3. The value of the indexes is questionable, given the measurements on which they are based. For what they are worth, they show SSA's political systems are no shakier necessarily than the norm in other broadly defined developing regions. To understand government failures in Africa, we need to look beyond political stability per se.

TABLE 3 ABOUT HERE

A more fruitful concept for trying to understand policy reversals specifically is the "hardness" or "softness" of the state. Myrdal (1968: 66) coined the phrase "soft state" to describe political systems that are prone to defer controversial policy decisions, and, more importantly for our purposes, to waive decisions they do take. When states are soft, citizens learn to ignore government edicts, which leaders themselves stop taking seriously. No one can count on the governing apparatus doing what it promises to do, which lowers expectations and feeds back on the demands people make of the state in the first place. A gulf opens between the intent of policy and the results.

What arrangements between state and society work best to harness society's energy for productive purposes? Regarding the type 1 failures where the state does the wrong

things, direct production of private goods and services is widely recognized as an area government better leave alone. African governments have historically attempted to occupy the "commanding heights" of the economy. Their state-owned enterprises usually give poor service and make losses, draining the public treasury. No one has anything good to say about pervasive, cumbersome regulations, either. African governments have a tradition of trying to micro-manage the actions of private business. When bureaucrats have too many controls, it creates bottlenecks, breeds corruption, and wastes resources. To fight the twin problems of inefficient public sector companies and overregulation, privatization and regulatory relief are called for. These are relatively non-controversial policy reforms, at least until the discussion turns specific and begins to talk about which companies to sell and which regulations to eliminate.

With respect to the type 2 errors of what the state should be doing but is not, three sets of activities to complement the market are usually considered important. In roughly increasing order of controversy they are: to provide certain basic public goods, to weave a social safety net, and to steer the economy in the direction of higher productivity.

Public Goods

Orthodox and heterodox observers agree that the private sector undersupplies many public goods—items that are simultaneously available to many people. Government

has to step in to fill the void. No capitalist society can operate productively without competent public administration to enforce contracts, protect property, prevent fraud and collusion, punish wrongdoers, and so on—a point discussed at length by Adam Smith two centuries ago (Goldsmith 1995b).[5] Important public goods beyond the provision of a stable legal environment for business include: a system for mass education, a network for public health, a physical infrastructure for commercial activity, and a means to protect the natural environment.

Government involvement in these areas does not mean the state must furnish the services itself, of course. There is wide latitude for contracting and for using incentives to get the private sector to participate in supplying public goods. Nevertheless, government still has to take the lead in overseeing the venture. Public goods cannot usually be supplied without any loss to someone. Therefore, coercive power must sometimes be used to force people to comply with measures that serve the larger society, including making them pay taxes to defray the cost of supplying public goods (Lindblom 1977: 78). Because of incompetence, dishonesty, and political bias, the state in most of SSA does an incomplete job of fostering a legal framework and basic services needed for market relationships to flourish (Sandbrook 1986). We will return to this question of African governments' support for the business environment in a later section of this paper.

Social Welfare

Restarting and Sustaining Growth and Development

A more controversial issue is how far the state should go to assure the supply of "merit goods" (things whose consumption is considered intrinsically desirable, such as food and shelter) to society. The market does not spontaneously generate these for everyone. Providing merit goods regardless of citizens' ability to pay can be an important source of political legitimacy and economic stability, as public decision makers from Classical Greece onward have understood. The ancient city states made regular, free distributions of corn to quell social unrest, and all governments have since taken rough edges off the economic contest by redistributing income through a variety of means. The downside is that such social spending can bust government budgets if left unchecked.

Most SSA governments became overextended in the 1970s, and assumed responsibility for more social programs (particularly food subsidies) than they could carry during the economic downturn that followed. This led to spending cuts under the banner of structural adjustment, an unintended result of which was to wear thin regimes' popular standing. To make adjustment more palatable in political terms, most plans for liberal economic reform now try to put on a "human face" (Jolly et al. 1987).[6] with social programs supposed to mitigate the fallout for poor people. The available data suggest more success in this area than is often imagined (see Table 4). Even unrepresentative regimes are under heavy pressure to maintain social programs, and few governments Africa seem to have made many net cutbacks.

TABLE 4 ABOUT HERE

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Taking 1980 and 1993 as the beginning and ending years, we see public spending on education and on health reportedly increased as a share of Africa's GNP. Probably as a partial result, people's access to water and health care services went up during the period (or the nearest available years). The proportion of the school-aged population in school stayed the same, though the quality of education may have eroded. Africans can expect to live longer now and they are more likely to be literate, so the UNDP's Human Development Index (which is based on these factors, plus real income) also rose over the 1980-94 period. While the absolute depth of misery on the continent is staggering, the trends look less adverse than many people think they are.

Industrial Policy

The most divisive concern about government's economic role is the third question of whether and to what extent the state should intervene to "get prices wrong"—that is to subsidize targeted industries as part of an industrialization or development strategy. According to the neoliberal creed such efforts to second guess the market are by definition a type 1 error, an illegitimate extension of government authority into the private sector. Let competitive forces settle which firms or sectors survive and which succumb. The heterodox view disputes this hands-off strategy, pointing out that the fast-growing Pacific Rim countries have usually been led by interventionist governments that pursued active industrial policies. Whether these nations succeeded

because of such policies or despite them is the controversy—though 1997's "Asian flu" financial crisis has plainly tested the plausibility of the former view. East Asian governments supposedly imposed internationally competitive performance standards, and weaned companies from subsidies once they reached that level (Amsden 1992). This supposition looks now to have misjudged the persistence of hidden allotments to favored businesses.

Can SSA governments reach socially desirable outcomes by helping certain firms and ignoring others on purpose? The record of African states serving as stewards of national interests does not inspire confidence. Too often they have acted more like "vampire states," to use Frimpong-Ansah's (1991) colorful designation, less concerned with developing world-class industries than with draining off society's productive resources. Such states seem highly unlikely to use selective incentives in a productive way to foster growth and development.

This is not a universal law in Africa, of course. The two African economic "success stories" of recent years—Botswana and Mauritius—each seem to have comparatively honest, developmental states (Good 1992; Meisenhelder 1997). This pair of countries follows policies that are more activist than the neoliberal creed advocates, and less predatory than it expects. Still, Botswana and Mauritius are the exceptions. History makes it reasonable to question how instrumental the majority of SSA states can be when they try to engage in industrial targeting. Even in places such as Korea and Indonesia, subsidies tend to flow to groups with the best connections, not to those with

the best business prospects. Investors are currently voting their lack of confidence in Asia's "insider capitalism" by pulling their money out of those countries. Keeping government economic intervention to a minimum is better from this point of view.

Economic analysis in SSA (and in other developing areas, too) is thus tending in the late twentieth century to unify around the advantages of freer markets *and* more effective, focused states. Making an either/or dichotomy of the private sector versus the public sector, although it can be an interesting way to score debating points, is far too crude a way of looking at things when it comes to the direction of public policy. Markets and states are mutually reinforcing institutions (World Bank 1997c; United Nations 1997). Most experts recognize this fact, and the mainstream school and its heterodox opponents are apt today to be questioning where to put the emphasis in development strategy, less so basic philosophy.

Policy Trends: Focusing on Institutions

Calling the overlapping views about African development needs the convergence of informed opinion would be too strong (Beckman 1991). Still, concurrence is greater than in the early 1980s. Official Washington seemed then to be working under the assumption that "in the beginning, there were markets." Whether many experts were really so naive to take a statement like this literally, they did put more stress on taking down barriers to exchange than on building the institutional prerequisites for effective

economic competition. This meant above all price and currency reform. Such reforms could literally be taken care of with a pen stroke, and thus looked comparatively easy to do.

It soon became apparent, were it not already, that getting markets to succeed is not simply a matter of freeing prices to obey the law of supply and demand. The institutions to support buying and selling, saving and investment do not come ready-made, and cannot be taken for granted. Liberalizing, say, a financial market, is one thing, but it is quite another thing to set up the equivalent of the U.S. Security and Exchange Commission to make sure investors have accurate information and are protected from financial scams. Moreover, an effective SEC cannot do its job outside a larger institutional framework of reliable police, courts, prisons. To the surprise of some in the development community, these things do not spring forth in a mechanistic or automatic way (White 1990). They evolve within the context of an increasingly sophisticated political system.

Washington consensus makers thus by the late 1980s began to devote more attention to so-called governance issues in adjustment and development (Bräutigam 1992).[7] Market-oriented economic policy, it was determined, was linked to "good government," defined as a pluralistic polity, limited by the rule of law and administered by an impartial, professional bureaucracy. Not only did government's role in the economy need redefining in the so-called Third World, parallel efforts were needed to bring government closer to the public and to improve its behavior toward citizens

(Brinkerhoff 1997).

Democratization is in a sense the political face of structural adjustment (Ould-Mey 1995). Liberal economic reforms paved the way for multiparty competition, encouraging dissent by curbing the power of the elite to run the economy in a way to pay off partners and confidants. Through political opposition and participation, the hitherto "silent majority" could be expected to make their leaders answer for mismanaging the economy. This would presumably keep pressure on for more rapid and equitable growth.

Institutional reforms can be painfully slow to unfold, however. Institutions are strongly influenced by the force of precedent, and existing ways of doing things get frozen in place. They may impede progress. Veblen (1914) coined the phrase "imbecile institutions" to describe organizations and modes of behavior that have outlived their usefulness or, worse, have come to serve irresponsible new purposes different from their initial ones. In particular, he noted the tendency for institutions to turn into shelters for vested interests over time. Such has been the fate of many African public institutions, which were ostensibly set up to provide public goods, but whose hidden, real function (whether by design or by evolution is immaterial) is often to carry away resources for private use. Agricultural marketing boards are a good example (Bates 1981). Veblen observed that imbecile institutions are tenacious. It is daunting to break the mold of systems, as in much of Africa, that have hardened around personalized power, arbitrary and unaccountable decision-making, widespread

dishonesty, and repression of dissent.

Consider civil service reform (Cohen 1993). Typical measures in SSA call for reducing the size of the bureaucracy and reorganizing it so it can operate more efficiently, while raising pay to attract and retain good people. This sounds sensible, but getting salaries up to sufficient levels means finding funds elsewhere, a difficult job even in a rich country. Widespread layoffs may be feared as politically suicidal because public jobs are needed to reward political allies, meaning reductions in force are an unlikely source of savings. Pay stays low, driving many civil servants to moonlight in the informal sector, and making it hard for them to put their best effort into government work. The poor pay also is an invitation to petty graft and embezzlement. Training programs may help some, but they also increase the marketability of public officials in the private sector, where compensation is more attractive. No wonder SSA civil services often prove unyielding to administrative reform (Lindauer and Nunberg 1994). Instead of doing more with less, as hoped, the civil services usually simply do less.

Policy Success or Mess?

Has structural adjustment worked? Judging from the economic record, the answer would appear to be a straightforward no. As Table 1 showed, Africa tends to be worse off in many respects than it was 15 years ago, when restructuring first came into vogue.

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The approach was supposed to end the stagnation already evident in the 1970s (Wheeler 1984). There has been plenty of economic pain since, but fewer gains in investment or growth than were anticipated back in the 1980s. Many citizens (especially smallholders) have defended themselves with an "exit" strategy, of withdrawing into the underground economy. It is no surprise that, according to one observer (Lipumba 1994), the dominant opinion among African intellectuals holds the mainstream policies to be part of the problem not its solution. If private transactions in the region often fall short of producing socially satisfactory results, as the heterodox critics like to point out, adjustment is obviously going to make matters worse until institutions evolve.

Are these criticisms fair? In fact more progress has been made in correcting the type 1 error of government excess than is often reported. The thrust of adjustment is to shrink the state, and, as Table 5 shows, government expenditure in Africa (including North Africa) was a slightly smaller share of the economy in 1995 than it had been in 1980. Partly, this must be due to over 2,000 public enterprises being privatized—another major goal of adjustment. Adjustment also aims to put government finances on a firmer footing, which should be reflected in diminishing budget deficits. The record shows deficits tapering off between the two years. So it is wrong to dismiss adjustment as a washout: some objectives have been reached.

TABLE 5 ABOUT HERE

Yet, global money managers are unimpressed with SSA's ability to put its public

finances in order. The region's average credit rating dropped over the interval. International corporations do not take quite so dim a view: direct foreign investment has increased significantly. There was net disinvestment in 1980 versus an inflow of more than $1 billion in 1996 (a big change, but still less than 2 percent of the Third World total).

Progress on the type 2 reforms to make government work better where government is indispensable are more difficult to measure than type 1, but decay seems as evident as improvement. Some states (like Namibia and Uganda) have stabilized significantly, while other states (such as Kenya or Zimbabwe) have been rocked by major social unrest, and others (like Liberia and Somalia) have collapsed into anarchy. (We will look at some efforts to quantify type 2 performance in a later section of this paper.)

The mixed verdict given by international creditors and investors suggests an orthodox rebuttal to the heterodox critique of adjustment. True, recent recorded African economic performance has not met expectations, but low performance cannot be taken as evidence against economic reform. The reason is that in many cases reform has barely been tried, official agreements aside. Instead, as already discussed, the typical pattern is stop-and-go, with announced changes in economic policy systematically being abandoned or watered down. The reneging can come officially, as when Zambia suspended its stabilization program with the IMF in 1987 following urban food riots. Or it can be *de facto*, for example, when Kenya delayed freeing the maize market in the 1980s, while maintaining an outwardly cooperative relationship with the World Bank

(Grindle 1996: 104-5). Whether adjustment works is therefore moot in those many countries that never really tried the approach. If anything is holding up economic progress in Africa today, according to the orthodox line of thought, it is the pattern of policy inaction and indecision, which makes investors and consumers skittish and postpones the economic recovery.

Furthermore, without counterfactual evidence, who can say for sure that Africa would be more prosperous now had it *not* taken on the partial reforms it did. If World Bank reports are to be believed, the open market strategy does produce faster growth for those countries that stick with it (World Bank 1994, Husain 1994)—though critics think the Bank is putting an optimistic spin on the data (Schatz 1994). Some countries seem better off for swallowing some of the international financial institutions' bitter medicine, for example Uganda. Its per capita GDP grew by an annual average of 3.5 percent for the ten years starting in 1985, one of the best rates in Africa. On the other hand, Ghana, another of the Bank's "star pupils," has managed to squeeze out a mere 1.1 percent per capita growth rate since 1983, when it entered its first structural adjustment agreement.

Yet, in the end, the handful of positive examples are not very encouraging, because they are rare and have *sui generis* features. To declare that dallying countries should imitate Uganda, and carry out adjustment more fully, is an unconvincing defense of the strategy. If the more common practice in SSA is to discontinue pro-market reforms, despite formal agreement to go ahead, then perhaps the fault lies with the orthodox

policies themselves. No matter how persuasive it is in economic theory, the rationale for adjustment sounds hollow if most participating governments consistently turn their backs on it.

Why is it that adjustment, which usually takes a major effort just to be approved, routinely faces reversals? Unraveling this issue of unsustained policy reform is the major task of the Restarting and Sustaining Growth and Development in Africa project. Part of the answer lies in the political and institutional realm, and in the process by which economic policies get chosen. Here the isolated examples of policy persistence may help us understand what it takes to maintain market-oriented economic strategies over the long haul.

Governance projects are not magic wands to remove the barriers to reform quickly. Nor is political will the way out of the conundrum, though it is often invoked as a *deus ex machina* when adjustment does happen. Political will is an empty notion. When deconstructed, it only means that politicians do what they want to do. A circular observation like this one gives no insight. The difficulty in many African countries today is not just that the authorities fail to put their hearts into economic reforms (though they may not); it also is that the authorities are unable to put their shoulders into reform, either, due to weaknesses in political and administrative capacity (Bräutigam 1996).

Explaining Sustained Reform

Restarting and Sustaining Growth and Development

To explain economic reform (or the lack of it) we can turn to three connected facets of institutions: interest groups, the state's representative and bureaucratic organs, and the political leadership. An interest group is an association of like-minded people who band together to press one cause or another, often to promote their own material well-being. To understand implementation problems, the constituencies with a stake for or against adjustment, and with the possibility to derail policy changes, must be considered. In Africa, the most important groups have been based on blood-ties and similar loyalties. Modern interest groups that cut across ethnic and regional divisions, such as trade associations or labor unions, have not usually played a central role in pressing public policy positions.

However, interests alone do not determine what public policies are executed. The way the state's representative and bureaucratic organs channel those interests is essential also. Of note are recent steps toward open communications and competitive elections in SSA. These institutional changes imply new ground rules for policy makers.

Finally, leadership is a critical factor in sustained economic reform. Political leaders always have a measure of latitude in choosing policies, and in much of Africa their maneuvering room may be particularly wide due to the absence of effective countervailing political forces (Gulhati 1990). What leaders elect to do, whose demands they decide to respond to, is thereby important.

We begin therefore by thinking about organized interests that exist outside the

official structure of government, and how these affect progress toward economic reform. Then we consider how the formal pattern of organization of the state influences lasting policy change. Finally the role of leadership is taken into account.

The Political Economy of Interest Groups

Since most groups in society seem to benefit from faster economic growth, for poor states not to execute policies that could boost their growth rates can seem senseless. Yet many African states behave this way. Bates and Krueger (1993: 2) call this the riddle of "good economics—bad politics." They and others find political economy (the study of the interaction of political and economic factors) a useful account for the apparent anomaly of self-destructive economic policy in SSA. In emphasizing the political logic (not the macroeconomic rationality) of what governments do, political economy also resonates with neoclassical assumptions about government's type 1 failures.

The basic point is that state intervention creates economic rents, which officials use to maintain a patronage network of friends and followers, and thus to remain in power. These rents are abnormally high earnings that accrue to the holder of a government license, quota, or other privilege. Rent-seeking results, as favored groups lobby or pay bribes to safeguard their artificial privileges. Such activity adds nothing to the stock of goods and services in the short term, and probably reduces it over the long term

through a deterrent effect on business. In Africa's often authoritarian systems, the disfavored groups who are not simply ignored can be violently repressed. Often public policies have an "urban bias," systematically mistreating groups in the countryside who are apt to have less clout with decision makers. In extreme cases, such as revolutionary Ethiopia, regimes pay scant attention to emerging rural famine, so marginal are the starving groups in the domestic political calculation.[8] Rents are extracted from the rural sector and distributed in the cities, buying off urban opposition with social spending and funding corrupt payments to government insiders. (More will be said about corruption later.)

For SSA governments, a dilemma ensues. The spoils system keeps the polity intact, while it also undermines the capacity of the economy to continue generating rents. To liberalize the economy may eventually snap the spiral of budget deficits and recession, but only by coming between the government and many of its supporters first. At the same time, the sacrifices demanded by the international financial community likely sap the government's power to silence its opponents through repression. A wavering attitude toward reform, a willingness to obstruct stated policies, can be seen as an effort to balance the domestic political equation with foreign aid. Most SSA governments act as if they have made a determination to preserve as much of the existing state of affairs as possible, and hence their grip on power, while simultaneously conceding the minimum reform to keep resources coming in from their international creditors.

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In trying to solve the good economics—bad politics puzzle, the political economy view reminds us to ask: good and bad for whom? When governments take action (or choose inaction), that policy creates winners and losers, no matter what its broader merits or demerits for society. For some groups, income or profits go up as a consequence; for others, they fall. Structural adjustment is this way, especially in the short run. The losing groups feel their injuries even if the net social outcome is positive. The losers may try to gain backing from neutral groups by raising inflammatory issues, such as the threat of neocolonialism and the alleged betrayal of national interests by domestic politicians who have sold out to international capital. This may be part of the reason that appearing to surrender to donors can carry a high political price for African governments, higher sometimes than presiding over slow or negative economic growth.

Political economy proposes that potential policy losers tend to mobilize to protect themselves from adverse decisions, especially if the expected cost of doing so is lower than the benefit. If they cannot stop a policy from going against them, the losers will try to stall or cripple the policy as a second line of defense. With structural adjustment, the losing groups typically include merchants and industrialists with access to rationed foreign exchange, and public employees whose salaries depend on deficit spending. Public employees often occupy especially strategic positions from which to disable economic reforms. (We will discuss this issue more later, when we get to questions of the bureaucracy.) The urban poor also may end up net losers (or at least feel like they

are) due to cuts in social spending, though falling inflation may help them. Perceptions here are more important than fact. Winners tend to be agricultural producers, for whom the terms of trade often (but not always) improve when controls are removed.

The winner/loser phenomenon sheds light on the fact that some aspects of economic reform seem more sustainable than others. In the developing countries, the greatest headway has been in macroeconomic policy and in agriculture, with mixed progress in deregulation of markets. Reforms of public enterprises and the financial system have been the most intractable (Husain and Ferric 1994: 1). The explanation may lie in whose interests are served by these reforms, and whose are not. As Herbst (1990) points out, the civil service system and parastatal corporations are among the most important sources of political patronage in Africa, and altering these institutions puts key constituents in jeopardy.

Underneath the umbrella of broad interest groups, narrower, internal conflicts will abound, so we have to be wary generalizing about who comes out ahead from any given reform. For example, depending on the crop and its subsidies, trade liberalization makes some farmers worse off. Indeed, Toye (1992) argues that the opposition of certain agricultural elites is a principal impediment to reform in Africa. Likewise, urban workers in export-oriented industries stand to benefit from outward looking economic policies, whereas workers in sheltered industries stand to lose. Farmers and workers also are consumers, as well as producers, and may suffer more from price increases and service cutbacks than they get back from reform. Such

crosscutting cleavages may paralyze groups from taking much action. Obviously, analyzing political interests case by case is necessary to learn the exact breakdown of winners versus losers.

Popular agitation in favor of adjustment is unheard of, while protest against these policies is not. Why is there this lack of symmetry? A maxim of political economy is that gains have less political salience compared with losses. Someone's motivation to get involved in public affairs is affected by his or her perception of the risks and rewards of doing so. As rule, when a well-defined group faces the prospect of a new penalty or loss, the members have a strong incentive to fight the threat to their well-being. That is partly because actual losses are felt more strongly than possible gains. [9] Another factor is that people's ability to organize increases in inverse proportion to their numbers, so small groups have an advantage establishing themselves and taking action.

By contrast, the potential winners of any policy (such as most export crop producers with structural adjustment) often lack capability to mobilize easily. Their numbers may be great, but great numbers are not necessarily an asset when it comes to people organizing themselves. As individuals, they are probably inclined to discount the benefit of a new or proposed change as too small, too uncertain, too distant to be worth fighting for—a situation known formally as the free-rider problem (Olson 1965). This term refers to the collective inertia that results when too few members of a large group can cooperate, though combined action might help make all of them better off. Smaller

groups (such as civil servants who are threatened with retrenchment) find it easier to act on their collective interests—including taking advantage of the majority. For them, the fear of having a current benefit removed is usually going to be a powerful stimulant, compared with an opposing group's less compelling wish to secure an additional benefit for itself.

The winner/loser explanation should not be pressed to its logical conclusion, however. Contrary to what a vulgar version of political economy might suggest, motivations other than short-term greed do affect policy making. People are not simply the guardians of what they think is best for their immediate material well-being. More cooperative, often self-sacrificing behavior takes place than the political economy model implies. Coalitions can emerge that seek a broader collective interest that overrides individual concerns. In Zimbabwe, for example, commercial farmers and urban business organizations have backed liberalization, though some members benefit from protectionism and are themselves not yet competitive on world markets (Skålnes 1993). A different illustration is Botswana, where the dominant class of cattle owners has protected its collective interests by pushing for open-market policies (Samatar and Oldfield 1995; Balefi 1996). The accidental byproduct was to expose much of the economy to competition.

The possible emergence of pro-reform coalitions does not deny the rule that losing interest groups can create an impasse if they are geographically or occupationally concentrated, or self-identified in some way. When they dig in to block or stall policies

that are to their disadvantage, the losers may push governments to back down on previously announced decisions. The most dramatic instances are what Geddes (1995) calls a "retrospective voting" model of interest group behavior—groups contribute little while policy decisions are being made, but take to the streets later to force the abandonment of policies they do not like.

That anti-adjustment demonstrations happen is no surprise. What is surprising and needs explaining is that they do not happen more often. In their study, Walton and Seddon (1994) count only 17 "austerity protests" in SSA between 1976 and 1992. An austerity protest is a large-scale collective action animated by liberalization policies urged by international agencies. Yet, during that time, African governments signed more than 100 structural adjustment loans with the World Bank or IMF (Kraaij 1994). Since the definition of an austerity protest is subjective, Walton and Seddon may have missed some important events. Still, the more significant forms of dissent to liberalization are probably subtle, taking place behind closed doors and involving elite groups that see themselves as losing from a more open economy.

Why the dearth of expressed mass complaint? In Africa, part of the reason may be that even rural residents have access to land, lowering the cost to use the exit option to express their discontent with policy, compared with the trouble of trying to exercise voice to get policy changed more to their liking.[10] The avenue of retreat to the informal sector is a safety valve for SSA regimes, and may help account for the mild political consequences of slow growth. The growth of the shadow economy, of course,

undermines the state's base of revenue, and makes it increasingly hard for government to provide public goods and curb negative externalities. Lacking a consistent institutional environment to work in, producers in the informal sector cannot capitalize on economies of scale, scope, and specialization.

This section has not mentioned an important set of interests—the foreign assistance community. A standard complaint about SSA reform programs is that they are undertaken mainly to please the international development agencies. The donor community does have the power to set the agenda for policy reform. Still, that power is limited, as proven by the many policy reversals that unfold in actually carrying out the neoliberal agenda. We will return to the question of donor/recipient relations in another section.

Institutions of Government

While political economy theory is attractive for being parsimonious, the same trait makes it an incomplete explanation for public policy in SSA. Just because public policy represents the resolution of conflict among competing interests, that does not mean policy can be reduced to what the most entrenched groups will allow. The theory paints a strong picture of interest group veto power, and sees deadlock as the logical outcome of interest group rivalry. This is an overly deterministic and static view. It does not offer much explanation for why, against the odds, the logjam sometimes

breaks and progress is made. It is interesting that current thinking in development strategy tends to see interest groups in a more positive light, as essential component of civil society. Active, participatory organizations are widely believed necessary to undergird enlightened government policies. We will look at this important topic in the next section, on the role of representation and democracy in Africa.

Political economy also largely ignores government's positive, type 2 functions. The state is not solely a mechanism by which the organized plunder the unorganized. A more nuanced approach to understanding policy change will take into account the way state institutions shape and channel people's interests for the common good. For clarity, it is helpful to remember that the state has three powers, a representative one whereby society's demands are aggregated and ranked, an executive power of carrying out decisions, and a judicial power of resolving disputes that arise out of those decisions. The representative and executive functions of the state are particularly important in questions of sustained policy reform.

Representation

A bare majority of countries in SSA can now be classified as emerging democracies. Authoritarian regimes have governed most countries since shortly after independence, but the pattern is changing. Nineteen-eighty-nine was a watershed, as the collapse of the soviet system and internal agitation provoked a wave of democratization (Joseph

1997). According to the crude categories used by Freedom House, a nonprofit organization that monitors political and civil rights around the world, only 14 African countries were deemed "free" or "partly free" in 1980. Seventeen years later, 25 countries were put in these categories. (See Table 6.)

TABLE 6 ABOUT HERE

The donors made political reform a condition of aid, though with mixed results (Grosh and Orvis 1997). In many cases, African democratization is centralized and top-down, with little sign of a participatory grass-roots culture establishing itself outside the capital city. What civil society exists are often the agents of urban factions (Wunsch and Olowu 1997). The regional political awakening is hesitant and fragile. African democracies are poorly institutionalized as a rule, following Huntington's (1968) idea that institutionalization can be measured by a political system's age and capacity to renew itself.

The key test is whether these democracies are able to carry out peaceful transfers of power through the ballot box. Few SSA countries have passed this test. We can count the number of elections where an incumbent was defeated, an opposition party won, or there was some other significant change via competitive elections. The results are reported in Table 7. From 1980 to 1995, only 15 such elections occurred in SSA, or an average of less than one for every three countries. By contrast, there were 55 significant electorally-based changes in power in Latin America and the Caribbean (1½ per country). Even Asia and the Pacific have seen a higher incidence of democratic

power transfers (½ per country). Only in the Middle East and North Africa are such elections less frequent than in Sub-Saharan Africa.

INSERT TABLE 7 ABOUT HERE

Many observers argue that democratic governments are ill-suited to the task of adjustment, on grounds that such regimes are not sufficiently insulated from special pleading and demands for relief. Lal (1985: 33) expresses this idea succinctly in the context of trade liberalization in developing countries: "A courageous, ruthless and perhaps undemocratic government is required to ride roughshod over these . . . interest groups." Elected regimes supposedly lack the same backbone, and are thought to be biased in favor of consumption and against investment. Bhagwati used to call this the "cruel dilemma" of a trade off between democracy and development—a position he has since rethought (Bhagwati 1995).

The reason to take a more nuanced view of democracy's relation to economic reform is the spotty record of autocratic regimes. Whatever advantages political repression has in going the distance with tough reforms (a questionable proposition in itself), these are offset by efficiency losses. Market economies need freedom of information, which is more likely to be nourished under open regimes. Dictatorships have fewer checks on corrupt behavior and wasteful public spending. So there is no reason to think that political pluralism necessarily clashes with market-oriented reforms, or that authoritarianism must make reforms easier. In fact, many rich democracies have undertaken far greater reform than SSA in recent years (OECD 1994). The pattern is

similar in Latin America, where dictatorships are less likely to liberalize (Remmer 1990; Lindenberg and Devarjan 1993). On this score, the new African democracies do no worse than the regimes they replace (Sandbrook 1996).[11] Democratization and economic reform may not always be compatible, but that incompatibility does not mean repression of democracy produces liberalization. Witness the Gambia, which was one of the longest-standing democracies in SSA before being overthrown in 1994. It has done little to adjust since on the economic front. The two other established multiparty systems— Botswana and Mauritius—have done well in continuously adjusting to changing economic conditions, without the crises experienced elsewhere in the region (Healey and Robinson 1992).

One reason democratization is sometimes an advantage for reforming countries, is that it eases the constructing of support networks among pro-reform groups. Some recent research on this topic finds that participation is a key issue for long-term reforms (Brinkerhoff with Kulibaba 1996). As power is shared, people may help design new government ventures and make them fit local needs and capabilities. Agreements among elites, made behind closed doors with little consultation and publicity, are less likely to stick. This is not an absolute: some policies ought not be discussed in public beforehand. Devaluation is an illustration. To avoid disrupting financial markets, it is better planned in secret and launched swiftly. Still, the general rule is that broader participation is preferred because it keeps governments from clinging to policies that help only their narrow support groups.

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Effective participation in policy reform seldom occurs outside a legitimate process of public decision making. Should the citizens consider the process proper, they may accept decisions to swallow many types of "bitter medicine." Should they mistrust or devalue the system, even open debate may not suffice to win their backing or assent for reform. The effort to broaden participation may actually backfire, though that does not make a closed-door approach superior.

In Nigeria, for example, the military government went to lengths in 1986 to air opinion and bolster support for an adjustment program that was "made in Nigeria for Nigerians," prominently refusing a loan from the IMF. Yet popular support for liberalization never took told (Moser, Rogers, and Til 1997). Some initial steps in Nigeria got off to a good start. Producer marketing boards were abolished, for example, and agricultural production soared. Food imports fell from 15% of consumption in the mid-1980s to 8% by 1993. However, political uncertainty returned in the 1990s and the production increases lost momentum (Economist Intelligence Unit 1997). Significant retrospective voting took place, especially among students, culminating in bloody, nationwide rioting in 1989. The government sought to blunt these protests through a special relief package to the universities (Albert 1995). By 1994, many market-based policies had been reversed, with controls being reimposed on foreign exchange, interest rates, and credit. None of this discernibly helped the economic situation in Nigeria.

Often a "honeymoon" phenomenon is observed in emerging democracies. The new

leader has a period when an unusual amount of reform is possible, especially if that leader sits on a solid political base, and faces a weak and divided opposition. At some point, however, the honeymoon ends, and any reforms that have been launched need to start to work. Unfortunately for adjustment programs, the compression of demand is felt immediately, trailed by the positive response (if it comes at all) of rising productivity and income. Even New Zealand, a country far better endowed than any in Africa, endured seven years of stagnation and recession until its restructuring effort finally began to show results (Kelsey 1995).

Can SSA governments wait that long? Should liberal economic reforms not pay off soon with noticeably better standards of living, the fledgling democracies will find their legitimacy questioned and may face the fate of their predecessors. As mentioned earlier in this paper, in all historical cases of capitalist development, governments have taken the sting out of the economic contest, using their power to equalize market outcomes and help provide for necessities. By contributing to support individuals whom the market no longer wants or by assisting them to get marketable skills or resources so they can compete, states can help pacify opponents of economic liberalization. Such actions, of course, run up against the fiscal austerity of adjustment. While many SSA governments have avoided cutting social programs as much as feared, they may not always be able to do so.

Bureaucratic Capacity

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Getting people's say in decisions is useful, but someone still has to act on those ideas and suggestions. This is primarily the job of the civil service, the non-elected officials responsible for carrying out whatever gets decided.[12] Africa's bureaucratic capacity to execute policy is ineffectual. The administrative state does some things political leaders do not want, and fails to do other things leaders do want.

Quantifying bureaucratic effectiveness is a challenge. Two approaches have been used. One is subjective, based on the opinions of external experts. Table 8 shows the results of three such subjective evaluations, comparing SSA with other developing regions. While the quality of these indexes is questionable, and they aggregate many diverse factors of both bureaucratic and political capacity, the picture that emerges for Africa is of an administration that performs below the average level of the developing world.

TABLE 8 ABOUT HERE

Researchers at the University of Maryland have tried to come up with a more objective measure of government capacity, and settled on what they call Contract Intensive Money (Clague et al. 1997). It is based on the proportion of non-currency money in the money supply. The higher the ratio, the greater the confidence in the government's capability. As Table 8 also shows, SSA again comes out near the bottom of the international comparison.

The political economy view provides a powerful critique of public bureaucracies and why they behave so poorly. Civil servants are an interest group (really a set of diverse

groups) in their own right. It is a myth that someone ever fully controls the state administrative "machine" from above. Employees who are striving to fulfill personal and group ambitions can drive outcomes, no matter what their supervisors or external clients want. Participants in the process will try to elude or defeat their opponents, frustrating leaders' intentions.

An alternative explanation for inferior implementation is possible, which gives less credit to self-aggrandizing, materialistic motivations of civil servants. This view stresses information constraints and transaction costs. In large organizations, such as a public bureaucracy, the failure to implement may be no one's conscious ill will, just the mistakes and misunderstandings of subordinates in the organization chain of command. So despite apparent agreement about goals, they may be incapable to carry out policy with precision (Pressman and Wildavsky 1979). African bureaucracies are particularly undisciplined, and the level of technical ability is low. When states are soft, many things happen by chance.

African states may not look soft on the surface. They usually have a centralized, hierarchical structure inherited from the colonial power. Focused on tax collecting and the maintenance of order, colonialism left SSA public administration systems with a legacy of legalistic and unresponsive practices (Mutahaba, Baguma and Halfani 1993). There is little room left for the sharing of responsibility with voluntary organizations or with lower levels of administration. People at the top of the organization pyramid often have too much to do, while those at the bottom have too little responsibility. No one

has time to carry out routine functions, let alone think strategically (Kiggundu 1989). Simultaneously, as discussed earlier, the civil service serves as an informal network of alliances based on personal, family, and ethnic loyalties.[13]

These are "lame leviathans" that cannot impose their will on society (Callaghy 1987). Consider the example of the security forces. No unit of government is more important to autocratic governments, but how many in Africa rein in their armies or police effectively? Lack of oversight is at least as evident among civilian agencies, whose officials ignore directives or collude with those they are supposed to regulate. Budget offices do not manage the budget (Sekwart 1997); central banks do not control the money supply (Fielding 1996); auditors general examine accounts years after the fact; tax departments fail to collect taxes (Bleaney, Gemmel and Greenaway 1995). Faced with such weak public agencies, ordinary people are apt to practice forms of active and passive resistance, refusing to pay taxes, smuggling, squatting on public land, and so forth. Even some African states once regarded as more proficient at taking dependable, concerted action, like Côte d'Ivoire used to be (Crook 1989), have languished in the recent economic crises. Is it any wonder that well-intended macroeconomic reforms often go nowhere?

State softness raises the question of how far the bureaucracy is insulated from civil society. There is a school of thought that holds the administrative malaise in SSA to be due partly to interest groups (especially clans and similar ascriptive groupings) having permeated the state. Officials are too accountable. Agencies are "captured" and lose

the capacity for independent action. Needed is a more independent set of government organizations, dedicated to the public interest. Botswana is sometimes cited as an example of a country guided successfully by an autonomous bureaucracy (Holm 1996). This is in essence a supply-side model of public administration. It stresses the need for technicians and experts to act evenhandedly and rise above external pressures. Rather than be controlled by some ethnic faction, or be immobilized by their competing demands, the bureaucrats supply services they know are needed for the greater good.

Another opinion takes roughly the opposite stand: Officials in Africa are not accountable enough. SSA bureaucracies are rendered ineffective by being too isolated from the needs of civil society. They continue in the colonial mode, giving orders to peasants and sticking to predetermined rules (Mukandala 1992). Inadequately challenged to do things people want, public functionaries drift into corruption, wastefulness, and inaction. The civil service has to be reoriented to become socially responsive or else be bypassed by non-government organizations that will do the job themselves. This is a demand-oriented model of public administration. It advocates bottom-up and flexible decision-making, which hopefully will make more realistic plans that can be carried out.

The debate can slide into an esoteric analysis of the relative autonomy of the state, or else into a populist critique of bureaucracy's inevitable missteps. The uninitiated may have trouble making sense of this discussion, which is unfortunate, for the truth probably lies somewhere between the polar versions of the argument sketched out

here. Supply and demand are both important in public administration. On the one hand, bureaucracies must be orderly and well-structured, following set procedures. They cannot be hypersensitive to threats and entreaties from their clients and other special interests. Otherwise they will play favorites or else fail to get anything done. Yet, bureaucracies cannot be sealed off from their client groups, either, because they need those groups for information and compliance. A classic example is the agricultural service, which when it works right, matches a supply of technical expertise to the demand of knowledgeable farmers (Goldsmith 1993)

Where economic reform is concerned, this implies the involvement with the bureaucracy of civil society organizations, notably the business and agricultural groups that stand to gain from a smaller government and less regulated. SSA has a long way to in incorporating the business point of view in the regulatory and policy process. According to a recent worldwide survey of the private sector, sponsored by the World Bank, African business leaders do not feel they have much voice in public policy (Brunetti, Kisunko and Weder 1997). Their perception of powerlessness is more acute than in other developing areas (except for the former soviet bloc, where managers claim they have even less input to government decisions). The African business leaders also complain they are not kept well-informed about new rules and regulations, and that they regularly worry about retroactive changes. Whether they would indeed solicit progressive policies is still an open question, but we will not know the answer until more avenues for business/government consultation are established in SSA.

Restarting and Sustaining Growth and Development

The Role of Leadership

We noted earlier that the losers' reactive influence on public policy is not as strong or effective as might be deduced from political economy theory. Governments sometimes do go against the wishes of important constituencies. They sometimes do work for the betterment of large sectors of society. Such actions may be rarer than hoped, but they do happen. It is important to note, too, that interests are not given. People learn what they want.

Taking on unpopular causes and educating society about them is a function of political leadership. Decisive leadership can overcome opposition, especially in soft states (Dunham and Kelegama 1997). In the past, most African heads of state have believed neither that adjustment will help the economy much, nor that it would assure their political survival. This was clearly the case in Nyerere's Tanzania. Economic reform made no sense to the Tanzanian leadership on ideological grounds, and they chose to play a long-running political game with the donors (Hyden and Karlstrom 1993). Nevertheless, the situation may be changing, as in Afwerki's Eritrea or Museveni's Uganda. There the paramount leaders have made a different calculation, come out in favor of liberalization, and backed it up with more than talk (even if the actions still come up short.)

Nelson (1989) observes that economic adjustment is usually built on a "fragile coalition" of political support. In a similar vein, Widner (1994) notes that successful

adjustment often results from a "reform bargain." She is referring to political deals worked out among political leaders, technocratic civil servants, and members of private associations and economic interest groups, which produce "political space" to implement orthodox reforms despite opposition. The crafting of policy is a complex skill, of assembling and holding together an often fractious alliance.

International donors often decide *a priori* what their client countries need and should do. The national settings change, but the advice stays the same: Remove import quotas, cut tariffs, reduce taxes, adjust interest rates, curb public borrowing, reduce subsidies, allow in multinational corporations, divest public enterprises, retrench the civil service, rewrite regulations on business. Referring to a slightly different list, Williamson (1993) calls these the Ten Commandments of reform.

The political economy approach takes a very jaundiced view of rulers, assuming hypocrisy and cynicism on their part. National leaders have proven they are willing to recite the Ten Commandments, if that is what it takes to get the foreign funds; they may be indifferent or hostile to living up to even one of the Commandments if it means disrupting the way things get done in their country. The donors sometimes collude in this charade, not wishing to use their leverage to the full extent and destabilizing a recipient government, and so jeopardizing their chances to continue making new loans. However, such a negative view of African leadership is not always justified. The more successful economic reformers often have characteristics of visionary leadership (Haggard and Williamson 1996).

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With the World Bank and IMF driving reform programs, the issue of policy ownership comes up. The term concerns the motivation and attitude of developing country officials, and whether they have "bought into" a policy (Jayarajah and Branson 1995). Reforms internalized by the national leadership obviously are going to be less subject to later rollbacks. As an explanation for sustained reform, though, the idea of ownership is near tautological, like political will, criticized earlier. It is observable in action: policy makers show their sense of possession by carrying out reforms, and by carrying out reforms they show that they feel the reforms belong to them. Policy ownership begs the underlying issue of what factors shape a leaders' mind in the first place—factors such as class background, education, professional experience, and the idiosyncracies of the human personality. Timing also is important. Brief opportunities may present themselves that any number of people might be willing to take advantage of. Such opportunities are probably historically unique, contingent, and therefore non-reproducible in other settings.

One area where leadership seems to have particular influence is political corruption. The abuse of public power for private ends, political corruption takes three basic forms: embezzlement or the theft of state funds, bribery or the demand for political payments in exchange for a favorable decision, and nepotism or the placement of family members or other supporters into key positions. Corruption is endemic in political systems, and often reaches obscene proportions in Africa (Gould and Mukendi 1989, Ayittey 1992). High-level officials are often to blame for the example they set.

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Mobutu's Zaire (now renamed Congo) is the extreme example. The late dictator erased the line between public and private property. Official presidential appropriations equaled up to half the annual government budget for capital investment. These and other public funds were diverted to Mobutu's patronage network, while he accumulated a personal fortune of perhaps $4 billion (Burns and Huband 1997). Zaire was bankrupted. Who can be surprised if average citizens in Africa resist government austerity, knowing "the wingless vultures in Mercedes" (Green 1989: 36) will not share the hardship.

On a less spectacular level, minor functionaries in SSA regularly abuse their positions for private gain, demanding "speed money" just to do their jobs or accepting small gratuities to overlook infringements of the rules. In a recent World Bank survey, African business people said they made such irregular payments frequently. The problem is reportedly less severe in most other developing regions, with the notable exception of the ex-communist transition areas (Brunetti, Kisunko, and Weder 1997). Such payments may not be significant in each incidence, but the total effect is to throw sand in the wheels of commerce and impair the economy's ability to function efficiently. Private capital will likely flee such conditions, not to return until well after they are alleviated.

Reducing petty corruption is possible, but we can expect little progress when higher-level officials are engaged in much more spectacular forms of theft (Kauffman 1997). The international community is beginning to become more concerned with this issue.

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At the World Bank, more audits of loans and stricter procurement procedures are being initiated. The International Monetary Fund (1997b) has a new proactive policy to withdraw support from countries where fraudulent activities has significant macroeconomic implications. But a local commitment to cleanup the political system is the key to reassuring the investment community that it can do business in the country without paying exorbitant corruption "taxes." One important consideration in credible leadership for economic liberalization is thus the projection of an image of honesty and simple living, setting the tone for greater probity throughout the government. Again, Museveni in Uganda may be a good example (Ruzindana 1997).

Conclusions

The way around implementation problems in SSA economic reforms is far from clear. The one certain fact about SSA economic policy is that many strategies have been tried over the past several decades, and that almost as many have been abandoned—though whether this was done prematurely, before they were given the chance to work, is still the subject of debate. The erratic evolution of development policy proves there are no quick fixes for Africa's economic failings, and that observation applies to the current enthusiasm for market liberalization. Private investment and greater competition have proven useful approaches to the generation of income and wealth over the longer run, but they do not happen absent a market-enhancing institutional

environment. To get there SSA governments are going to need good leaders, who can build a firmer base of representative and bureaucratic organizations, which can translate the electorate's demand for a better life into concrete policy.

Notes

1.I would like to thank Rita Aggarwal, Deborah Bräutigam, Clive Gray, Merilee Grindle, Mary Hilderbrand, Malcolm McPherson, John Munene and John Thomas for their very helpful comments on earlier drafts of this paper.

2.The term institution has two overlapping meanings in social science, which results in some confusion (Goldsmith 1992). In management and organization theory, an institution usually refers to a role or organization; in economics and sociology an institution is often a rule or convention. There are major divergences between these two definitions, between being role- and rule-oriented. The first type of institution resides in deliberately constructed human groupings and has boundaries and a mission; the second is diffused among a multitude of people and lacks a boundary or mission. Roles have concrete reality, rules are mental conceptions. But the meanings coincide in part, because no organization can survive without rules and rules often need an organization to enforce them. In either form, institutions have two important properties: they shape the way people act and they persist over time. The focus of the paper is institutions in the organizational sense.

3.Terminology in the domain of policy reform can be confusing. Strictly speaking, the term "structural adjustment" covers policies to liberalize foreign and domestic trade to increase an economy's efficiency. This is distinct from "stabilization," which refers to efforts to overcome a fiscal and monetary crisis by curbing consumption. Structural

adjustment policies thus attempt to stimulate economic supply, while stablilization policies seek to restrain demand. The former policies are associated with the World Bank, the latter with the International Monetary Fund. Notwithstanding the distinctions, the two sets of reforms follow a common logic of trying to eliminate distortions and disequilibria in the economy. In fact, stabilization can be seen as the first step in a longer process of adjustment and structural change. Following common parlance, adjustment is understood here to include stablilization measures, and is treated as a synonym for liberalizing economic reforms that aim to make national economies more open and responsive to market forces.

4.While the heterodox view stresses defective markets, that does not mean it ignores government failures and the importance of institutions. To the contrary, it faults the Washington orthodoxy for being ahistorical and unconcerned with how the absence of market-supporting rules and practices limits capitalist development in SSA (Stein 1994).

5.Instituting a proper system of law and order, or what Adam Smith variously referred to as an "exact," "tolerable," or "regular" administration of justice, is one of several "duties of the sovereign" he enumerated. Government, Smith argued, is needed for "protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it" (Smith 1776: 651). Decentralized, competitive markets cannot provide this type of security; properly functioning government can. Recent

regression analysis supports Smith's contention that the rule of law (and property rights in particular) is a precondition for economic growth (Goldsmith 1995a; Leblang 1996). Also see Knack and Keefer (1995) and Paulo (1997).

6.There is a vibrant debate over the social cost of free-market reforms in developing countries, which many people assume must be borne mainly at the lower end of the income distribution. This is not proven, however, and often leaves out of the equation the social opportunity cost of not adjusting. Some studies suggest that the well-being of the poor is not harmed by adjustment, and may even be helped as economic impediments are removed (e.g., McPherson and Radelet 1995; Sahn 1996). Also, many reform programs try to preserve targeted help for the poor, so the issue of who bears the social cost of adjustment is still open.

7.Governance has special meaning in the development lexicon, covering both civil service reforms and democratization. In the 1960s, developing countries were seen to lack effectively performing governments. Over time, experience taught that improving performance was not a narrowly technical issue of training bureaucrats and writing better rules and laws. To be effective (in the sense of meeting majority demands), government was seen to need the countervailing power of an organized civil society. This led to today's stress on the rule of law, freedom of association, respect human rights, and other dimensions of political liberalism (for example, Canadian International Development Agency 1995; Japan International Cooperation Agency 1995, United

Nations Development Program 1997a).

8.Other states in Africa, notably Botswana, Kenya, and Zimbabwe, have had "silent success" in preventing famines (Drèze and Sen 1990). It is noteworthy that these states often have important pillars of support among rural people.

9.Machiavelli (1513: 55) offered the following diagnosis for this conservative human tendency: "[T]here is nothing more difficult to carry out, nor more doubtful of success . . . than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order, this lukewarmness arising partly from fear of their adversaries, who have the laws in their favour; and partly from the incredulity of mankind, who do not truly believe in anything new until they have actually had experience of it."

10.Marx (1969: 377-78) had another explanation for why farmers, who could benefit from forming lobbying groups, are sometimes not inclined to rally themselves for collective ends. He attributed it to the physical and social seclusion of the countryside:

> The small-holding peasants form a vast mass, the members of which live in similar conditions but without entering into manifold relations with one another. Their mode of production isolates them from one another instead of bringing them into mutual intercourse. . . . [T]he identity of their interests begets no community, no national bond, and no political organisation among them, they do not form a class. They are consequently incapable of enforcing their class

interest in their own name, whether through a parliament or a convention.

11.This issue touches on the broader question of whether democratization encourages economic growth. The cross-national research is ambiguous. According to a pair of recent literature reviews, covering a total of 24 empirical studies (Sirowy and Inkeles 1990; Przeworski and Limongi 1993), six of the studies reviewed find that democracy has a positive effect on economic growth. Yet, four other studies find a negative relationship and four find a conditional relationship between democracy and growth. Ten studies fail to turn up any significant relationship. Brunetti and Weder (1995) think this is because the variable democracy does not capture the factors that alarm or reassure investors. Leblang (1997) suggests, however, that the inconsistent results are due to different research designs and that democracy does have a positive effect on growth. Przeworski and Limongi (1997: 179) conclude: "Poor countries can develop under democracy and democracy can flourish in poor countries if they develop."

12.An analytic distinction is being made here between decision-making and implementation, a breakdown that does not exists in real world, as public administration specialists have long noted. For one thing, civil servants often need to interpret vague statutes, and thus have considerable decision-making authority. For another, they often make their decisions in direct consultation with client groups. Recognizing that the categories are not airtight, separating implementation from decision-making provides a useful framework for thinking about the failings of the bureaucracy in SSA.

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13.Why Africa states look this way is an interesting question. Moore (forthcoming) suggests the reason has to do with their source of income. These are rentier states, dependent now on foreign aid, that have never had to put much organizational effort into raising revenue. Nor have they had to establish effective reciprocity with citizens, providing real services in exchange for taxes. The result is a lack of accountability and responsiveness.

TABLE 1

RECENT ECONOMIC PERFORMANCE INDICATORS IN SSA

	1980	1995
Gross domestic product	$293 bil.	$297 bil.
GDP per capita (1987 prices)	$634	$507[a]
Gross domestic saving (% GDP)	27%	16%
Gross domestic investment (% GDP)	23%	19%
Merchandise exports	$77 bil.	$72 bil.
Total external debt	$84 bil.	$226 bil.
Net foreign aid (1994 prices)	$13.2 bil.	$16.8 bil.
Net foreign aid as % GDP	2.6%	6.1%
1,000 km roads per 1 million pop.	3.3	2.4[b]

[a]1994 [b]1990

Sources: World Bank (1997a, 1997b); United Nations Development Program (1997); Development Assistance Committee (1997).

TABLE 2
CHARACTERISTICS OF STATES
Sub-Saharan Africa versus other developing regions

	SSA	Latin America & Caribbean	No.Africa & Middle East	Asia & Pacific
Average age of regime (1992)	27 yrs	20 yrs	37 yrs	35 yrs
Years current executive in office (1996)	10 yrs	6 yrs	19 yrs	9 yrs
Ethnolinguistic diversity index (higher is more diverse)	65	26	25	44
Coups and revolutions per country (1970s and 1980s)	0.31	O.31	0.55	0.24
War-related deaths (1945-92)	6.5 mil.	714 K	1.4 mil.	14.1 mil.

Note: Countries included vary for each measure. The figures are unweighted means for the regions. The **ethnoliguistic diversity index** measures the probability that two randomly selected persons from a given country will belong to the same cultural or language group.

Sources: Derbyshire and Derbyshire (1996), Gasiorowski (1996), Easterly and Levine (1996), Sivard (various years).

TABLE 3
INDICATORS OF POLITICAL INSTABILITY
Sub-Saharan Africa versus other developing regions

	SSA	Latin America & Caribbean	No.Africa & Middle East	Asia & Pacific
Political instability quotient (1948-82)	35.7	32.5	38.5	55.2
Sociopolitical instability index (1960-85)	4.39	5.54	-1.05	3.20
Democratic instability score (1948-82)	3.51	4.86	2.84	3.61

Note: Countries included vary for each measure. The figures are unweighted means for the regions. The **political instability quotient** is calculated from the number of political demonstrations, riots, political strikes, deaths from political violence, assassinations, armed attack events, political executions, coups (successful and unsuccessful) and the government profile. The **sociopolitical instability index** is based on the number of politically motivated assassinations, the number of people killed in domestic mass violence, the number of successful and unsuccessful coups, and a dummy variable for democracy. The **democratic instability score** is a measure of the magnitude and frequency of shifts from democratic to nondemocratic rule and back. The degree of democracy is defined in terms of participation, inclusiveness, competitiveness, and lack of coercion. In each of these indexes lower is more stable.

Sources: Alesina and Perotti (1996), Gupta (1990), Arat (1991).

TABLE 4

SOCIAL PERFORMANCE IN AFRICA

	1980	1994
Public expenditures on health (share of GNP)	4.7%	5.8%[a]
Public expenditures on education (share of GNP)	1.0%	2.5%[a]
% pop. with access to safe water	34%[b]	47%
% pop. with access to health services	45%[c]	53%[d]
Calories per day as % requirement	99%[b]	97%
Gross enrollment ratio (% age 6-23)	39%[b]	39%
Human Development Index	.283	.400

[a]1993 [b]1982 [c]1985-87 [d]1990-95

Note: Some figures include North Africa (not Egypt), and others exclude some SSA countries. The **Human Development Index** is based on three indicators of the quality of life: life expectancy, education levels, and average income. The index runs from 0 to 1, with higher numbers representing greater human development. Due to changes in methods, numbers are not strictly comparable between the two years.

Source: Sivard (various years), United Nations Development Program (various years).

TABLE 5

SELECTED GOVERNANCE INDICATORS IN AFRICA

	1980	1995
Total Government Expenditure (% GDP)	29.7%	28.0%
Overall government deficit (% GDP)	-6.4%	-3.3%
No. of public enterprises	6,069[a]	4,058
Net foreign direct investment (million current $)	-$54	$1,630[b]
Average Credit Rating (0 is worst, 100 is best)	26.2	21.1[c]

[a]prior to 1990 [b]1996 [c]1997

Note: Some figures include North Africa, and others exclude some SSA countries.

Sources: African Development Bank (1997); World Bank (1997a); *Institutional Investor* (various years).

TABLE 6

POLITICAL REGIME TYPES IN SSA
Number of Countries

	1980	1997
"Free"	3	8
"Partly Free"	11	17
"Not Free"	32	23

Source: Freedom House (various years).

TABLE 7

POWER TRANSFERS TRHOUGH ELECTIONS (1980-95)
Sub-Saharan Africa versus other developing regions

	SSA	Latin America & Caribbean	No.Africa & Middle East	Asia & Pacific
Rate per country	0.3	1.6	0.1	0.5

Note: Includes only elections where an incumbant was defeated, an opposition party won, or there was some other major change in office.

Source: Freedom House (various years).

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TABLE 8
INDICATORS OF GOVERNMENT CAPACITY
Sub-Saharan Africa versus other developing regions

	SSA	Latin America & Caribbean	No.Africa & Middle East	Asia & Pacific
Government Quality Index (0 is worst, 100 is best)	31.2	48.7	42.4	45.3
Efficiency of Govt. Structure Index (1980-83) (0 is worst, 10 is best)	5.3	5.9	5.9	5.7
Index of Economic Freedom (1998) (1 is best, 5 is worst)	3.5	3.0	3.2	3.1
Contract Intensive Money (1969-90) (0 is worst, 1 is best)	.67	.80	.65	.79

Definitions: The numbers are unweighted means. Exact countries vary for each measure. The **Government Quality Index** is based on subindices for economic management, social development, government orientation and citizen participation. The **Efficiency of Government Structure Index** comes from an index developed by Business International's commercial country risk report. The **Index of Economic Freedom** is an effort to gauge the degree of national economic openness, based on how countries do on a list of ten economic factors. The factors are trade policy, taxation policy, government consumption, monetary policy, capital flows and foreign investment, banking policy, wage and price controls, property rights, the level of regulation, and black market activity. Countries are graded on a scale of one to five for each item. These grades are averaged to compute the total rating for each country, with lower numbers indicating greater economic liberalization. **Contract Intensive Money** is the ratio of non-currency money to the total money supply. This indicator reflects the proportion of transactions in a society that rely on third-party enforcement. In well-governed societies, currency is only used for small transactions; in poorly-governed societies, the opposite is true.

Sources: Mauro (1995); Huther and Shah (1996), Holmes, Johnson and Kirkpatrick (1997), Clague et al. (1997).

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EQUITY AND GROWTH THROUGH ECONOMIC RESEARCH (EAGER)

PUBLIC STRATEGIES FOR GROWTH WITH EQUITY (PSGE)

RESTARTING AND SUSTAINING GROWTH AND DEVELOPMENT IN AFRICA

A study coordinated by the Harvard Institute for International Development (HIID) in collaboration with other members of the EAGER/PSGE consortium and research institutes and independent researchers in Africa

COUNTRY STUDY: SENEGAL

SCOPE OF WORK

RESTARTING AND SUSTAINING GROWTH AND DEVELOPMENT IN AFRICA

COUNTRY STUDY: SENEGAL

SCOPE OF WORK

A. Overall objective

The objective of the study is threefold:

1. to identify the main political, social and economic factors that are currently preventing Senegal from pursuing rapid economic growth, defined as a prolonged annual rise of GDP above 6 percent;
2. to suggest concrete ways and means of overcoming those obstacles; and
3. to produce a publishable volume and propose other measures to disseminate the findings of the research in a subsequent phase of the project.

B. Background

Numerous studies by the IMF, World Bank, other donors, and Senegalese institutions and researchers have analyzed various aspects of the Senegalese economy; in many cases, quantified existing disincentives to investment, employment, output and exports; and proposed measures for reducing or eliminating these obstacles.

Leading recent studies include:

1. latest IMF Article IV Consultation Report
2. latest IBRD country policy report
3. Eliot Berg's April 1997 report
4. Various CREA studies
5. Others to be identified

C. Research strategy

The present study will begin with a selective review of the foregoing literature, summarizing (and, in passing, critiquing) principal policy recommendations. Proceeding from (i) the literature review, (ii) analysis of the latest data, and (iii) new surveys (see below), the study will cover five major themes:

1. definition of key elements of an economic strategy for Senegal that the research team believes will promote rapid growth and development;
2. identification of the economic strategy currently pursued by the government, in terms of both (i) stated policies and aspirations, and (ii) actual implementation.
3. identification of those elements of the preferred strategy (point 1) that are missing from government's program and its implementation (point 2);
4. analysis of obstacles to implementation of the missing elements (point 3); and
5. proposals for overcoming the obstacles and restarting growth.

D. Disclaimer

The study must not mire itself in the fine details of analysis and policy recommendations contained in existing documents. Its objective is to highlight the principal obstacles arising at the level of the country's economic management and recommend ways of overcoming them.

E. Issues related to exports as an engine of growth

Mainstream economic analysis of Senegal's development, by national and foreign researchers, has consistently argued that:

1. the economy cannot attain a rapid growth path without expanding certain sectors, among them manufacturing, tourism and other services, several percentage points faster than the growth of GDP;
2. domestic demand cannot absorb the level of output required to achieve acceptable GDP growth, hence Senegal's exports of goods and services must grow even more rapidly; and
3. breaking into export markets requires a high level of efficiency and productivity, meaning *inter alia* that Senegalese manufacturers and producers of other exportable goods and services must have access to inputs of goods and services at world market prices or below.

Accordingly, the study will pay particular attention to obstacles that have (i) limited growth of Senegal's manufacturing output to 3.7% p.a. during 1980-95, (ii) held manufactures to only a quarter of total exports at present (IBRD, *World Development Indicators 1997)*, (iii) similarly limited growth and exports of sectors that have played a dynamic role in the growth of fast-growing economies in Asia and other developing regions of the world, and (iv) retarded the development of markets for Senegalese products in the UMEOA and other African regional groupings.

F. Foreign exchange rate

Because the repressive effect of the overvalued franc CFA up to 1994 has been thoroughly documented, the study will not repeat that analysis. However, it will review the latest evidence on the impact of the January 1994 devaluation, assessing to what extent the devaluation has created the incentives required to achieve reasonable growth of investment, employment, output and exports. The study will also consider the impact of the current fixed exchange rate on Senegal's international competitiveness, and if it finds the impact to be negative, it will describe options for overcoming the problem. Among options to be considered is the possibility of persuading the UMOA to allow the rate to adjust gradually in response to market signals.

G. Course of economic reform

The study will summarize the principal stages in the introduction, implementation and suspension of economic reforms in Senegal. It will identify factors that have obstructed growth hitherto, paying particular attention to instances in which pro-growth reforms (such as those linked to liberalization) were approved and implementation commenced, then later significantly weakened or abandoned altogether.

The report will assess the influence of different participants--the business community, political groupings, donors--both in bringing about policy change and in disrupting change. It will assess the government's motives in adopting and suspending reforms.

H. Economic, institutional and political obstacles to reform

Among obstacles to reform identified under (G), the study will pay particular attention to, and analyze the significance of, the following:

1. Actions by beneficiaries of economic rents, created by state intervention in the economy, to preserve such rents
2. Exploitation of monopoly/oligopoly power by commercial interests linked to established foreign suppliers, leading to higher costs for Senegalese producers and impeding Senegal's integration with the global world economy
3. Subversion of procedures instituted by the government to ensure expeditious, "one-stop" approval of foreign investments
4. Continued control, by agents of the state, of functions supposedly devolved to local communities, thereby frustrating the intent of government's efforts to stimulate community initiative and mobilization of local resources through decentralization
5. The issue of whether the electoral cycle, by motivating the government to promote the vested interests of selected voting blocks and campaign funders, has retarded reform

I. Survey of industrialists and ancillary businesses

The study will review evidence adduced by industrialists, traders, and producers of other services (whether for household consumption or in the form of inputs to industry--e.g. transport and telecommunications), regarding sources of inefficiency and low productivity, as well as other disincentives to investment, employment, output and exports. Obstacles to be reviewed include those under (H) above. Particular attention should be paid to obstacles imposed by the government bureaucracy, such as corruption, harassment, and delays in granting approvals. In this connection the researchers will conduct surveys among leaders and key members of such groups as:

1. Le Conseil National du Patronat
2. Le Conseil National des Employeurs du Sénégal
3. Le Syndicat des Professionels de l'Industrie du Sénégal
4. Trade unions

These surveys will comprise structured interviews conducted by senior researchers in lieu of asking respondents to complete written questionnaires.

As far as practicable, the study will gather independent evidence to evaluate respondents' assertions.

I. Stance of decision makers

Through interviews with observers of the Senegalese political scene, and (insofar as access is granted) with decision makers, the researchers will appraise and evaluate the decision makers' perceptions regarding the causes of Senegal's slow growth and ways of overcoming them. The study will seek answers to questions such as:

1. What is decision makers' vision of Senegal's economic future? Do they take seriously the possibility that Senegal could attain a per capita GDP comparable to that of fast-growing Asian countries?
2. Are decision makers aware of the fact that, in 1962, Senegal's per capita GNP was almost 30% more than South Korea's, and amounted to 82% of Mauritius' figure and 62% of Malaysia's, whereas in 1995 the three countries had per capita GNPs equal to 16, 6.5, and 5.6 times Senegal's, respectively?
3. What are decision makers' perceptions (if any) regarding (i) the sources of rapid growth in Asian countries, and (ii) reasons why Senegal has been unable to copy that performance?
4. What role (if any) do decision makers think that Asian political leaders played in promoting industrial growth and exports? To what extent do they claim they are striving to play a similar role?
5. To what extent are decision makers aware of recommendations made by multilateral and bilateral agencies and Senegalese economists with regard to completing the process of structural adjustment and expanding Senegal's integration with the global economy, and what is their evaluation of those suggestions?
6. What are the channels of communication for decision makers to hear about obstacles to doing business in Senegal? To which segments of the business community are they listening?
7. How far are decision makers aware of complaints by foreign investors and the local business community about bureaucratic obstacles to investment and business activity, including the high cost of contract enforcement and other needed support from the Senegalese legal system? How seriously do they believe they are striving to resolve those complaints?
8. What do decision makers consider to be the main obstacles to implementing growth-oriented policy recommendations with which they agree? What role do they attribute to vested interests (notably political opponents, labor unions, businessmen), as opposed to external economic shocks (weather, falling world prices, competition from Asian economies, etc.)?
9. In what policy departures do decision makers see the best possibilities for removing

obstacles to rapid growth in the foreseeable future? What do they claim to be doing to implement those measures?

10. Are decision makers aware of any foreign complaints about Senegalese export goods? Are they aware of recent foreign queries about Senegalese products that have gone unfulfilled? Why, for example, was it not possible to satisfy an order for hand-made shoes that followed publicity in the French magazine ELLE? Have the leaders taken concrete measures to push the Senegalese business community into exporting? What examples can be cited?
11. If the researchers find that decision makers are devoting less time and effort to promoting economic growth than is necessary and desirable, what are the principal demands competing for their attention and what would be the opportunity cost to the decision makers of paying more attention to growth issues?

On the basis of independent evidence, the study will evaluate decision makers' responses to these and other questions.

J. Conclusion

The researchers will give their best judgment regarding Senegal's growth prospects if present trends continue, and indicate what steps might be taken by Senegalese analysts and donor agencies to help improve policies and implementation of reforms. Among the steps considered should be a program of circulating and defending the study's findings, including distribution of summaries, workshops, etc.

K. Deliverable outputs

The study will produce at least four deliverable outputs:

1. An initial work plan
2. A progress report
3. A draft final report
4. A final report in publishable form

L. Research supervision

The study will be carried out under the guidance of a research supervision committee, containing representatives of the Senegalese government, private sector and academic communities. The committee will meet at least four times, to consider, and recommend improvements in, the scope of work and initial work plan, the progress report and the draft final report.

ECONOMIC AND SOCIAL RESEARCH FOUNDATION

STUDY ON BUSINESS CONTRACTING PRACTICES IN TANZANIA

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3 February 1998

(SHORT VERSION)

Preliminary Draft Report. Language Not Corrected. Incomplete reference list.

Paper presented at the ***Equity and Growth Through Economic Research***: Project EAGER Workshop, Glenburn, Muldersdrift, WITS, South Africa, February 4-6, 1998.

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1. INTRODUCTION

1.1 Background

This report addresses business contractual practices in Tanzania. The focus is appropriate at the present time given the major reforms that the Tanzanian government has opted for in overhauling economic policies and structures that were hostile to private economic activities. Tanzania initiated a wide spectrum of policy reforms beginning with the initial Structural Adjustment Programme (SAP) of the early 1980s followed by Economic Recovery Programme of the mid 1980s, which was subsequently extended to a sister programme of 1989-92. These reforms had some positive effects as reflected in the improvement of the economic performance following the Economic Reform Programme in terms of increased real GDP growth rate, which rose from 2% between 1981-86 to over 4% in the 1986-96 period. Concomitant with this was the improvement in export growth, fall in inflation rate, increased levels of investment and emergence of private business enterprises in the country.

Research findings (RPED, Tanzania, 1994 and Ringo, *et al,* 1995) have shown that most small enterprises do not use formal legal contracts in their transactions. Most of them rely on agreements based on friendship, mutual trust, kinship or long-term business relationships. Some small enterprises operating in sectors with established contractual practices such as civil works, transportation and insurance use formal contracts. However, as the size of business increases, the usage of formal legal contracts also increases.

State legal institutions are of primary importance in contracting and contract enforcement. Tanzania has a legal system based on the English Common Law system. Alternative dispute resolution mechanism including mediation, conciliation and mini-trial are still in infancy stage in Tanzania. Initial research findings (Ringo, *et al,* 1995) have shown that small enterprises view the legal system in Tanzania as unsuitable for dispute settlements not only because a court suit may tarnish the enterprise's image and lead to loss of future business, but also settling disputes in court is expensive in terms of time, costs and corruption.

1.2 Objectives

The main objectives of this study were three fold; to investigate and describe in detail the activities related to business contracts; to assess the potential presence of business contracting culture in the Tanzania's business community and to probe the nature and varying dimensions of these practices. The investigation and assessments were intended to reveal the extent and viability, reliability and nature of various mechanisms that seek to ensure adherence to business contracts in Tanzania. The study sought to answer the following research questions:

- What are the salient features of business transactions in the sectors surveyed?
- What modes of contracting and contract enforcement are used in these transactions?
- What features of legal institutions can facilitate or obstruct contracting?
- What relationships can be drawn among the legal institutions, contracting practices and the nature of business contracting? *and,*
- What are the implications for policy and legal reform to promote private sector growth?

The study was geared at testing the following hypotheses:

- The quality of the state's legal institutions affects firms with regard to the choice of formal and informal contracting and contract enforcement practices and, thereby, its growth potential.
- Well developed legal institutions are necessary for the facilitation of efficient transactions among individuals.
- The absence of strong legal institutions (belonging to the state) in Tanzania causes transactions to "flee to the poles" of spot-market deals -- or vertical integration.
- Informal or quasi-legal practices are predominantly used instead of formal legal processes among small, medium and large-sized businesses.
- Informal practices are most frequently used where relationships of trust exist based on either (a) status (ethnic or religious criteria) or (b) a history of frequent interactions.
- Legal institutions dealing with contract that are well-understood and perceived as legitimate by the business community are more effective in forging business relationships among firms than when such is not the case.

1.3 Rationale

Although contracting and contract enforcement are commonly viewed as critical for exchange and economic development, little empirical work has been carried out in Tanzania in this area so far. This study was envisaged to address this shortcoming and help provide information on contracting and contract practices in Tanzania. It will allow for cross-country comparison using developed criteria of assessing efficiency of business contracting of the studied countries; Ghana, Madagascar and Tanzania. The study is important at this present time because it helps understand the strength and weaknesses of institutional environment; and will present the complexity of interwoven formal and informal contracting modes with the corresponding evaluation of the results of policy change and capacity building in Tanzania after a period of state-controlled activities.

1.4. Methodology

This study was designed to be carried out in three countries; Ghana, Madagascar and Tanzania. The primary focus has been on Tanzania. This report present findings from fieldwork survey carried out in Tanzania which was intended to test and ascertain the stated hypotheses. The study has focused on firms in the manufacturing sector. Three sub-sectors in this sector were selected, namely, the Food Industry, the Chemical Industry and the Wood/Timber and Furniture Industry (collectively referred to as the Wood Industry). A total of 105 enterprises were surveyed; these include 46, 12 and 47 enterprises in food, chemicals and wood sub-sectors, respectively. The survey was concentrated in four main regions (with enterprises in brackets) of Dar es Salaam (70), Arusha (10), Moshi (10) and Mwanza (15). The Central Bureau of Statistics data files were used during the process of selecting the surveyed enterprises. The weighting and distribution of the selected firms was made deliberately to reflect enterprises' concentration in the four regions.

Collection of primary data and information was conducted through a questionnaire that was designed to capture major enterprises activities in relation to contracting. Macro level data and sectoral data were obtained from official sources, directly from official publications of the

Tanzania government, and indirectly from semi-official documents such as unpublished evaluation studies, court cases and law enforcement organizations. It is important to note that access to the semi-official sources is not in all cases automatic, as it depends on personal relationships with those in possession of those documents. ESRF/IRIS researchers in collaboration with the respective regional statistical officers (RSOs) collected both the primary and secondary data.

The primary, macro-level and sectoral data and information which show the characterization and industrial performance of the manufacturing sector in Tanzania, particularly the performance of the selected sub-sector were analyzed by two main statistical packages; SAS and EXCEL. This report emanates from a synthesis of the analysis and interpretation of the primary qualitative and quantitative data; and the secondary data set including literature materials.

2.0 Major Research Findings

2.1 Structural Adjustment Reforms (SAP):

Market-oriented reforms featured in structural adjustment programs have not always yielded the expected results of economic growth, social efficiency and equity. Consequently, attention has been focused on the role of the legal, regulatory and judicial (LRJ) environment in the performance of developing economies. Institutional economists have adopted the principles of information and transaction costs from the law and economics literature to contend that the ability of social institutions to effectively reduce such costs may explain the difference between performing and non-performing economics. In Sub-Saharan Africa, including Tanzania, the inability of existing legal, regulatory, and judicial institutions to reduce those costs and, in many instances, their tendency to raise such costs, may help explain the continent's poor economic performance despite more than a decade of structural adjustment efforts.

2.2 Business Performance in the 1990s

Like many developing economies, Tanzania adopted comprehensive economic reforms in the mid-1980s. Despite these reforms, the share of industrial output in GDP (at 1985 prices) dropped during the 1985 to 1995 period from a peak of 9.6% to 6.5% respectively. The performance of the manufacturing sector had not been very impressive for a number of reasons: many industries continued having inadequate working capital, experienced high interest rates, inflation accelerated, infrastructure (energy and water) continued to be inadequate and business supporting organizations remained weak. Recently, the share of the industrial sector in GDP (at factor cost and 1992 prices) increased to reach 8.3% in 1996 from 8.2% attained in 1995. On the other hand, the industrial sector grew at 4.8% in 1996 in contrast to an increment of 1.6% attained in 1995. The sector has for a long time been a source of employment, foreign exchange and a potential sector for the economic growth of Tanzania.

The growth that has been observed in the food, wood and chemical sub-sectors has been almost completely limited to the urban areas. Any new firms that do emerge in the rural areas are likely

to be small and informal. There has been a correlation between government legislation liberalizing the economy and increases in the numbers of firms. The ownership structure is changing. The indigenous people are increasing the proportion of businesses that they own, but they are hindered by the lack of clear government strategy to offer assistance to them. At the moment, most of the informal sector activities are owned by Africans whilst much of the formal sector is under the control of Tanzanians of Asian ethnic origin. Despite investment policy reforms, foreign investment is at the moment limited. Foreign companies will not invest in Tanzania until it has developed conducive business environment such as strong contractual practices.

A further trend is that the government is no longer the prime consumer of privately sector produce. Now, the government's role has declined and business transactions are mainly between agents in the private sector. A competitive market economy is evolving to fill many of the roles that the government has moved away from. SMEs have emerged that are highly responsive to market demands. The lack of middlemen means that they can respond more or less instantly to changes in demand. On the down side, their limited size means that they frequently cannot take advantage of economies of scale. Many small and medium industries have had limited capacity to invest in technology and modernization of their ageing plant and machinery partly because of their weakened financial position.

2.3 Salient Features of Business Enterprises

The most important suppliers are private Tanzanians firms. The increasing role of the private sector is evident from the findings in that the largest share of the transactions going to the private sector suppliers, both private Tanzanian and foreign. State enterprise involvement is at an all time low due to the reforms that have seen, among other things, the reform of the parastatal sector -- the bastion of state involvement in business activities. Consequently, the increasing and tremendous exit of the state enterprises from the economic scene is complemented, on the other side, by the increasing role of the private sector striving to carve its niche in the system, replacing the state enterprises as important suppliers and customers.

Interestingly, most of the firms intimated that the suppliers and customers were not of the same

tribe or ethnic group. This then would seem to negate any contention that tribal and ethnic relations are pivotal in facilitating exchange and contracting but rather normal business interaction provides an important avenue for the flow of information. This then raises doubt on the position of the school of thought which postulates the centrality of ethnic and tribal relations as underlying exchange and informal contracting and, therefore, contract enforcement. It seems evident that firms are far more concerned about business than which tribe the suppliers or consumer comes from.

The state of the infrastructure in Tanzania is not very well developed. Dependence on road transport is very high hence its dominance in the mode of transportation as shown above. It is at least easier to access otherwise inaccessible areas through roads. The cost of air transport is prohibitive not to mention the fact that many areas cannot be accessed by air in Tanzania for lack of the necessary infrastructure. In most cases it was shown that firms arrange and pay for the transportation . The erratic nature of the infrastructure makes it difficult for a supplier or producer to commit her or himself to a given time. Flexibility is required, and this is another reason why informal contracts are preferred. A given party might well not be able to supply or collect on a given date for reasons that are genuinely out of his or her control. This is particularly a problem in the inaccessible rural areas.

The Tanzanian economy has been increasingly liberalized and the economic management has gradually been moving away from central control towards a market economy. The government has undertaken to reduce its involvement in directly productive activities and the private sector is been encouraged to invest in those activities. Both input and output markets are very competitive with a wide range of suppliers and products of different types. Many products seem to have many competitive customers. However, the products produced in the country have been facing a stiff and unfair competition from products produced in other countries. This is so especially to food, textile and chemical products which have been facing a threat of closing down. Most of products produced in the country are not competitive in both local and foreign market due a number of reasons. These include *inter alia* relative high cost of raw materials, high water charges, relative high cost of electricity, telecommunication services and poor managerial capabilities.

2.4 Modes of Contracting and Contractual Enforcement:

Most of firms surveyed used documents with their suppliers all the time with the remaining firms using documents most of the time or just sometimes only. The main reasons given for using was the protection of their rights and interests. Others cited legal requirement and standard practice. These findings evince the recognition within the manufacturing of the essence of protection of legal rights and interests through use of documents as well as an understanding of the need to comply with legal requirements. In the manufacturing sector, the findings show that it is not standard practice to use formal contractual documents in the day to day business transactions.

The validity of oral contracts is recognized by the Government of Tanzania, (GOT). It is not necessary to have a full formal contract providing you have some evidence that you had an agreement. In the present framework, businesses view legal action, with its associated costs in time and bribery, as absolutely the last resort.

Of the firms using contracts in Tanzania, most micro and small enterprises are not in the practice of using formal legal contracts in their transactions. Most of them rely on agreements based on friendship, mutual trust, kinship, or long term business relationships. Trustworthiness and the friendly relations that emanate from business relations are seen as important factors in maintaining long term commercial relationships. Some micro and small enterprises operating in sectors with established contractual practices including civil works, transportation and insurance use formal contracts. As the size of businesses increase, so does their use of formal legal contracts.

It is anticipated that as the economy becomes more modern, complex and diversified, especially with regards to methods of payment and infrastructure, the need for contractual arrangements will rise. At present, the preferred method of payment is Cash On Delivery (COD), which is the least troublesome from a legal standpoint. As the use of advance payments and credit grows, so will the need for the security provided by contracts. Further to this, as the financial sector reforms, national payment system and infrastructure improve, it will become more feasible to carry out business over longer distances. This expansion will doubtlessly involve business with individuals

or firms with which no relationship already exists. Seeing as knowing the other party for a long time is given as the main reason that formal contracts are not used, in this new environment where firms who have previously had no dealings interact, the use of contracts can be expected to increase. For this growth in the use of contracts to be as beneficial as possible reduction of corruption in the present social-economic and legal systems is essential.

Knowledge of the law is not high, and it is suggested that organizations such as the Confederation of Tanzanian Industries (CTI) and the Tanzanian Chamber of Commerce, Industry and Agriculture (TCCIA) be utilized to raise awareness of the legal rights of businesses on both the demand and supply sides. This will also encourage firms to join these organizations, which can be expected to help the government to become aware of the needs of private enterprises.

2.5 Legal, Regulatory and Judiciary Framework.

Despite the social, economic and political reforms in Tanzania, however, many business units have fallen victim to the inadequate and ineffective LRJ framework. The existing LRJ frame work has proved itself to be ineffective in catering for their needs in terms of licencing, registration, sales, contractual relations, credit, security, property rights, and dispute settlement. Most commercial contracts in Tanzania, except those involving transactions under customary law, are governed by the Law of Contract Ordinance Cap. 433 and the Sale of Goods Ordinance Cap. 214. While the Law of Contract Ordinance deals with general principles, the Sales of Goods Ordinances provide for specific rules providing for sales transactions. These ordinances have not been amended since they were inherited from the colonial government. That is the Tanzania's laws are generally based on the UK's laws from the 1950s. The UK has modernized her laws, but Tanzania has not. This process needs to be combined with a reduction in the cost of access to the law, which is at the present prohibitively high.

2.6 Dispute Resolution

Dispute resolution is a function of the enforcement mechanism. Low-cost and impartial contract enforcement procedures provide a critical incentive for the formation of complex commercial agreements thereby facilitating trade and economic growth. The procedures enhance predictability by restraining opportunism among contracting parties which reduction decreases the cost of exchange while promoting transactions.

One lesson that can be drawn from the IRIS-ESRF (1997) survey is that there is a very limited use of the legal system and such other methods as arbitration. Parties mostly resort to bargaining and renegotiation as these methods while cost-saving, also preserve the commercial relationship. Where this fails, the option seems to be to exit from the relationship by ceasing to do business with the other party. This could be partly attributed to close business relationship that the parties are linked.

Although business agreements are meant to be legally binding as they create legal rights and obligations, here it would seem that business gain is the overriding factor; firms are more concerned with staying in business and legal consequences arising out of failure to honour one's obligations comes in third after fear of losing reputation. Another factor pointing towards importance attached to business relations in honouring obligations is the fact that some respondents pointed towards fear of disrupting relationships as the force behind their honouring their agreements.

Respondents rated the speed, confidentiality, competence, fairness, impact on relationships and predictability of the outcome as excellent in the case of private arbitration. The cost involved was seen to be satisfactory but certainty of enforcement was rated as poor. As regards dispute resolution through the courts, the respondent noted that the speed and cost was as poor as was the impact that the settlement method had on relationships. Confidentiality, fairness, predictability of outcome were rated as excellent. Competence of the courts in resolving disputes was rated as being satisfactory.

2.7 The Quality of the State Legal Institutions:

The IRIS-ESRF (1997 findings revealed that in Tanzania the quality of the state's legal institutions affect the firms with regard to choice of formal and informal contracting and contract enforcement practices and thereby its growth potential. The poor quality of the legal system which does not have well developed legal institutions which are necessary for the facilitation of efficient transactions among individuals. The system does not perform well as the laws have not kept abreast with the changes, both economic and social; it lacks professional capacity due to lack of properly trained staff who are also not motivated due being lowly paid; corruption is rampant within the system; the recording systems are antiquated and improper, and general paucity of facilities. Such deficiencies result into nightmarish bureaucratic procedures and practices, lack of transparency and lack of accountability. These constraints need to be addressed seriously.

Notable, however, is the fact that informal contracting practices and enforcement procedures have their own niche among Tanzanian business environment. It cannot be denied that informal and quasi-legal practices are predominantly used instead of formal legal processes among small, medium and large-sized businesses. They seem to have legitimacy and have proved to be effective. The socio-cultural factors upon which trust hinges are essential in analyzing the changes that can be brought to the system to improve it. Such trust, the study has established, is based more on long term relationships resulting from a history of frequent transactions. Status based on ethnicity or religion has not been found to be a very strong base for developing the requisite trust.

Needless to say, no two social situations are alike and therefore the systems that work in a different economy may not necessarily work in Tanzania. This calls for the need to develop a system of contract enforcement that takes into account existing institutions, both formal and informal by giving legal recognition and force to the informal and to strengthen the formal by amending and harmonizing the various pieces of legislation having bearing on contracting practices and enforcement procedures, and ridding the judicial system of all the vices and making it more efficient, accountable and, most important of all, transparent. This would restore the faith

of the enterprises in the system and thereby serving as an incentive to enter into contracting arrangements as certainty of enforcement would be there.

Legal institutions dealing with contract that are partial understood, capable and perceived as legitimate by the business community are more effective in forging business relationships among firms than when such is not the case. Furthermore, considering the economic reforms and the advent of the market economy, changes in the legal system in Tanzania should be designed to accommodate and service foreign capital needs deriving from foreign investments, both existent and potential.

2.8 LRJ Policy Implications and Recommendations:

Deliberate policy measures should be undertaken to broaden legal awareness and literacy as at present, although many of the respondents claimed to be knowledgeable about contract laws, the truth of the matter is that legal literacy still remains law. Legal awareness as an attribute of social organization is a recent phenomenon emanating from political reforms that came in the wake of economic reforms. Law books are hard to find with the number of law libraries being limited. Technically, in Dar es Salaam, a member of the general public cannot gain access to the only two meaningful law libraries i.e. the one at the High Court of Tanzania which is for the exclusive use of the Honourable Judges, Magistrates and Advocates and the University of Dar Es Salaam Law Collection the use of which is restricted to the members of the academic staff and students of the law faculty only!

The issue of legal awareness and legal literacy is a the crucial business contractual issue: legal representation. Of recent there has been a growing number of enrolled advocates but seemingly they do not seem to satisfy the needs of there would be clients by being inaccessible due to the high fees charged. In general, soliciting the services of a legal counsel is regarded as being prohibitive. Enforcement is the function of, among other things, the employment of professional legal services. In this particular regard deliberate policies and legislation should be put in place to ensure fair representation of all the parties in the contracting arrangements by providing for smooth and affordable access to professional legal services.

This study has concentrated on formally registered manufacturing firms. However, findings by NIGP-ESRF (1996) on the informal sector shows the existence of non-formalized firms as still facing several constraints. These include absence of a national policy on the informal sector, inaccessibility to credits, problems in obtaining raw materials, poor marketing channels, infrastructure and outdated technology. There is a need of creating an enabling environment that will lead to the transformation of the firms operating informally. This involves rationalizing the bureaucratic procedures that involve the formalization procedures, providing the firms with the necessary infrastructure for formal operations, access to credit facilities as well as upgrading them with managerial, organizational and marketing capabilities.

The GOT is committed to the promotion of private business opportunities and investment. To this end there have been devised development strategies to uphold and guarantee the sanctity of property rights. In its endeavour, the Government desires to maintain a legal system that is transparent, credible and effective and gives due guarantee to protection of business enterprises. The government reviews all principal legislation whose provisions contradict the current policy of economic liberalization and in specific private enterprise development. The legislation will be critically reviewed with the view to streamlining and removing all provisions that are unnecessarily creating bottlenecks and constraints in the business practices. There is a need to review law of contract and related bodies and institute more appropriate to and supportive legal and regulatory environment to facilitate smooth business transactions. This may need changes in systems of adjudication, laws on arbitration and alternative dispute resolution. These legal reforms will reduce costs of adjudication and increase collective contract enforcement options available to business practices in Tanzania.

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(c) The Bill of Exchange Ordinance, Cap. 215
(d) The Investment (Promotion and Protection) Act, 1990
(e) The Hire Purchase Act, 1966
(f) The Companies Ordinance, Cap. 212

Equity and Growth in Africa through Economic Research/ Public Strategies for Growth with Equity (EAGER/PSGE)

Study on Restarting and Sustaining Growth and Development in Africa

Kenya Country Study
Draft Scope of Work (Abridged)[1]
January 1998

1. Restarting and Sustaining Growth and Development in Africa

1.1. Background to the Study

A number of recent studies have shown that sound macroeconomic management, effective institutions and policies that enhance competitiveness and productivity are important in explaining the difference in rates of economic growth and development across countries. The results also highlight the link between sustained increases in real output per capita (economic growth) and general improvements in welfare (development), supporting the view that there is no trade-off between rapid growth and development.

Compared to the Asian economies, African countries have both grown more slowly and experienced a decline in the general welfare of their populations. Indeed, declining income and deteriorating welfare have become self-reinforcing in many African countries, with major implications for productivity and competitiveness.

During the last two decades, African governments have initiated structural reform programs in an effort to restart and sustain the economic growth process as a means of achieving broad-based development. However, the reform programs have failed to lead to sustained economic growth and development for the majority of African countries, despite the mobilisation of substantial intellectual, technical and financial resources by the international community.

While factors external to African economies have been used to explain the lack of sustained reform, the most important determinant of poor economic performance have been internal. These include the lack of commitment to economic reforms, poor institutional capacity to implement reform programs and the powerful influence of short-term political expediency. Restarting and sustaining growth and development in sub-Saharan Africa requires that these and other internal constraints be acknowledged and addressed.

[1] The scope of work is based on submissions by the proposed principal researchers, viz. Dr. Njuguna Ndung'u (University of Nairobi), Professor Peter Kimuyu (Institute of Policy Analysis and Research, Kenya), and David Ndii (finalising his PhD in Economics at Oxford University).

1.2. Purpose of the Study

The proposal submitted to USAID for the study posed the following question: 'What institutional, political and economic obstacles have prevented sub-Saharan African governments from embracing and implementing reform programs to the extent necessary to achieve high, sustained rates of growth and development, and how can these problems be dealt with in the future?' From this can be distilled the following three key questions:

1. Why has economic growth in Africa stagnated during the last two decades?
2. How can economic growth be restarted?
3 Once restarted, how can high rates of economic growth be achieved and sustained?

These questions will be examined through an analysis of the recent economic growth experience in the five countries of Senegal, Ghana, Uganda, Kenya and Tanzania.

An important objective of the overall study is to contribute to the policy debate in these, and other, countries on how to restart and sustain economic growth and development. Senior policy makers will therefore be invited to contribute to the study through in-country seminars and an Africa-wide conference. They will also be encouraged to integrate the study's findings into their national policy agenda.

1.3. Themes

The question of restarting and sustaining growth and development in Africa will be approached through the following three themes:

1. Macroeconomic Management. This theme will examine the efforts to achieve macroeconomic stabilisation using monetary and fiscal policy measures. The causes of policy reversals will be identified and proposals developed as to how reform and growth-oriented policy measures can be sustained.

2. Political and Institutional Analysis. This will assess the role and performance of government, political groupings and the bureaucracy in the economic reform process. It will examine how the political and institutional obstacles to reform and growth can be overcome.

3. Production, Productivity and Competitiveness. This theme will assess the incentive structure at the microeconomic level for domestic and foreign firms to make long term investments, raise productivity and enhance the competitiveness of exports. Measures to encourage greater investment for faster growth will be proposed.

1.4. Organisation of the Study

The growth experience in the five participating countries will be analysed in the context of the three themes highlighted above. The overall study's research team has been arranged along thematic lines and into individual country research teams.

Collaborating country researchers will develop detailed country studies examining each theme in the context of the relevant country. The country studies will both draw on and contribute to, the analysis on the cross-cutting themes to be carried out by the researchers from the EAGER/PSGE consortium member institutions.

The country studies and thematic research will be discussed in country seminars and workshops as well as in an Africa-wide conference at the overall study's completion. The final research reports will be compiled into a consolidated volume on restarting and sustaining growth and development in Africa.

1.5. Overview of Hypotheses

The proposal for the overall study contains a discussion of twelve hypotheses which reflect some implicit choices made by African policy makers, and provide a flavour of the practical issues flowing from the implicit and explicit policy choices that have often been made. These policy choices seem to have been based on various (usually unstated) assumptions, including the view that macroeconomic instability does not significantly influence the achievement of sustained growth and development, or that the expansion of non-traditional exports depends primarily on the removal of trade restrictions primarily in OECD markets.

While these hypotheses are illustrative of some of those which will form part of the study, individual country research teams will develop and examine specific hypotheses relevant to the particular circumstances of the country being studied.

2. The Kenya Country Study: Scope of Work

2.1. Objectives of the Kenya Country Study

In the context of the overall objectives and thematic structure of the Restarting and Sustaining Growth in Africa study, the research team for the Kenya Country Study intends to examine the following three broad hypotheses:

1. Macroeconomic Management. The liberalisation of Kenya's economy has resulted in macroeconomic instability. Efforts by policy makers to maintain stability have, for example, led to high levels of interest rates which have discouraged long term investment and stifled the country's rate of economic growth.

2. Political and Institutional Analysis. Kenya's rate of economic growth lost momentum because of the institutional failure, intentional or otherwise, to recognise the ethnic nature of the conflict between growth and redistribution, with the subsequent failure to develop a consensual and transparent institutional framework for articulating and arbitrating the conflict.

3. Production, Productivity and Competitiveness. Kenya's unproductive labour force, deteriorating physical infrastructure and inappropriate incentives have eroded the country's productivity and export competitiveness. However, the success of its horticultural sub-sector in penetrating world markets with exports of fresh vegetables and cut flowers, holds some policy lessons for wider application in the domestic economy.

The scope of work for the Kenya Country Study in each of the three thematic areas follows.

2.2. Macroeconomic Management

2.2.1. Introduction

The main objective of the research under the theme of macroeconomic management, is to show that instability in the basic macroeconomic variables is responsible for the slow investment response to Kenya's liberalisation, resulting in poor economic growth performance. The research will also define intermediate targets for the basic macroeconomic prices (exchange rate, interest rates, inflation) and propose policy instruments and actions designed to attract long term investment for high and sustainable rates of economic growth (above 6% per year).

There are several important stylised facts about Kenya's economic performance following more than a decade of experience with economic reforms:

1) Economic recovery has been disappointing, with real per capital GDP growth improving only marginally.

2) Economic management has tended to focus on the short-term resulting in conflicting goals and outcomes characteristic of a policy dilemma. In the period of liberalisation 1993-7, Kenya experienced short-run speculative capital flows which responded to the positive differential between domestic and international interest rates. Policy makers have encountered a policy dilemma in targeting a competitive exchange rate and low inflation in a floating exchange rate regime. In order to pursue these goals, the authorities have, at times, intervened in the foreign exchange market to stabilise (and occasionally defend) a currency buffeted by volatile capital flows. This action has had to be followed by the sterilisation of these capital flows in the money market, through the raising of domestic interest rates. The result has been short-term stability in the exchange rate, but at high interest rates which mitigate against increased domestic investment and rapid economic recovery.

3) A key factor behind the precarious recovery, is the slow response of private investment to macroeconomic stabilisation and the adjustment of basic prices.

4) Related to the above is the existence of policy and political risks. Potential investors have exercised a waiting option, until the front-loading of investment returns are sufficient to compensate for the risk of long term investments. Most capital inflows have been short-term in nature, focused mainly on financial instruments and commercial activities, rather than in irreversible fixed investments.

5) The existence of a large external debt (and the short-term internal debt) has given rise to a debt overhang problem with adverse effects on investment and growth. Again, because investors expect current and future taxes to be increased in order to service this debt, they continue to exercise a waiting option in their investment decisions.

Liberalising and Stabilising Kenya's Economy - The Policy Dilemma

Significant steps have been undertaken in the liberalisation process but important structural weaknesses have emerged in the economy. As the process of liberalisation continued, the financial market showed short-run fluctuations due largely to the volatility of foreign exchange flows.

By 1994, the policy focus was to keep reserve money on the targeted path while intervening in the foreign exchange market to minimise the appreciation of the exchange rate. However, interventions in the foreign exchange market led to an increased money supply. This had to be sterilised through the sale of Treasury bills in open market operations. In order to make the commercial paper attractive, the rate of interest had to be high relative to other financial assets. Several effects resulted from these policy actions:

- The high interest rates jeopardised the chances of economic recovery and discouraged investments necessary for future economic growth.
- The high interest rate on Treasury bills maintained a positive differential between domestic and foreign interest rates, perpetuating the problem of short-term speculative flows of private capital.
- The Treasury bills sold in the sterilisation process expanded the government's domestic debt. The short-term (91 days) bills were bought mainly by the financial sector. The resulting short-term lending behaviour of the financial sector has not encouraged the development of the financial sector.
- The Treasury bills rate was not flexible downwards, due to the short-term nature of the commercial paper and government debt, making it an inappropriate instrument of monetary policy.

Recognising that high interest rates were counterproductive, the authorities adopted a policy aimed at lowering interest rates, from 1994. This proved difficult. Lowering interest rates led to the massive redemption of Treasury bills and substantial outflows of capital, proving that short-term capital inflows were attracted by the high domestic interest rate and were subject to abrupt

reversal. By extension, it showed that capital inflows were not being invested in irreversible fixed assets.

The sizeable capital outflow put the currency under significant pressure to depreciate. In response, the authorities defended the shilling by drawing down the stock of international reserves. This led to a depletion of reserves to critically low levels, making the policy unsustainable. The policy dilemma thus developed a third dimension - low levels of international reserves - in addition to the volatility in the exchange rate and high interest rates.

To protect international reserves and stabilise the exchange rate, the authorities resorted to monetary measures. This required that the non-bank financial institutions be subjected to cash ratio requirements (like the banks), discouraging the discount window at the Central Bank through high and punitive interest rates, and raising the short-term Treasury bills rate. While these measures stabilised the exchange rate and helped replenish foreign exchange reserves, interest rates were much higher and long term growth prospects continued to be dim.

This summary of Kenya's experience with liberalisation and stabilisation discusses how intermediate targets and goals and the accompanying policy instruments have been managed, and how they have affected the long-term goals of growth, poverty reduction and expansion of employment.

Key questions to be examined under this theme of macroeconomic management in Kenya include:

- What factors are responsible for the poor growth performance in Kenya? Can their relative strengths be assessed?
- Can growth be sustained in the face of negative impact from external indebtedness and precarious macroeconomic management?
- What policy options are necessary to revive and sustain growth and development in Kenya in the next decade?
- What role do financial sector, exchange rate policy and accompanying policies play in streamlining intermediate targets to achieve long-term goals?

2.2.2. Specific Policy Research Issues

The research and analysis of Kenya's macroeconomic management will examine the following issues in detail:

a) The historical decomposition of growth factors.
b) The impact of macroeconomic instability on Kenya's long-term economic growth prospects.
c) Exchange rate management and accompanying macroeconomic policies.
d) Financial sector development.
e) The external and domestic debt and its constraints on investment and growth.

a) Historical Decomposition of Growth Factors.

This section will examine Kenya's recent economic growth performance to disentangle the sources of growth from a historical perspective, assess the identified factors' relative importance in explaining the country's growth experience and determine which of these may explain the slow down of economic growth during the last decade.

b) Macroeconomic Instability

This analysis will show that the slow investment response to liberalisation is linked to the instability in basic macroeconomic prices. Indicators of macroeconomic instability include:

- High and rising inflation.
- High debt service obligations.
- Debt overhang and its fiscal effects.
- Declining real investment.
- Fiscal imbalance.
- Real exchange rate volatility and real exchange rate misalignment.
- High and volatile domestic interest rates.

c) Exchange rate management and accompanying macroeconomic policies

The various elements of the analysis will include:

- The evolution of exchange rate policy and exchange rate regimes. What has triggered regime changes?
- The real exchange rate as a tool of economic management and a measure of the competitiveness of domestic products. Real exchange rate equilibrium and episodes of misalignment. Targets for a competitive exchange rate and links to international reserves and balance of payments.
- What is the optimal policy response to short-term capital flows?
- The inflation experience under alternative exchange rate regimes and the policy response to unstable and rising inflation. The exchange rate as a nominal anchor and other plausible nominal anchors to domestic prices.
- Accompanying macroeconomic policies:
    - Central bank independence - can the Central Bank of Kenya be an internal agency of restraint?
    - The policy effectiveness of direct and indirect monetary instruments.
    - Adoption of indirect instruments and constraints to their effectiveness.
    - The role of interest rates: The term structure of interest rates as an indicator of monetary stance and of economic activity.
    - Dynamic inconsistency of low-inflation monetary policy.

d) Financial Sector Development

This analysis will examine:

- The financial sector's structure, ownership and performance.
- Bank assets concentration.
- The incidence of bank failures.
- Financial sector's role as a conduit for savers and investors.
- Financial sector reforms and their outcome.
- Financial liberalisation and the emergence of secondary financial repression.
- Required secondary financial reforms.

e) The external and domestic debt and its constraints on investment and growth.

This analysis will examine:

- the role of donor funding in Kenya's sustainable economic growth.
- the role of the HIPC (Highly Indebted, Poor Countries) debt initiative for Kenya.

2.2.3. Research Methodology

The analysis of Kenya's macroeconomic management will be empirically driven so as to show and quantify the relative importance of various policy actions. The empirical analysis will also show the links and transmission mechanisms between policy actions, the intermediate targets for basic macroeconomic prices and long-term economic growth. Research activities will include an extensive review of recent literature on Kenya's macroeconomic management, interviews with key economic policy makers, the compilation of updated macroeconomic data, modelling and time series analysis of the collected data.

2.3. Political and Institutional Analysis

2.3.1. Introduction

Economic growth and institutional development are mutually reinforcing processes. To accelerate growth, a poor country needs to nurture economic, social and political institutions that mobilise, allocate and utilise resources efficiently. Institutional development itself, like any other investment, consumes scarce human and material resources. Economic growth increases the amount of resources that a society can use for the purpose.

An economy's growth rate can rise due to rapid accumulation of the factors of production (physical capital, human capital and labour) or due to an increase in factor productivity on account of efficiency improvements and technical progress. Recent growth studies indicate that the divergent growth trajectories observed in developing countries over the last three to four decades-- between South East Asia and the rest of the developing world in particular-- are largely

a reflection of differences in the rates of factor accumulation, as opposed to differences in factor productivity.

In light of this evidence, this component of the study will examine the institutional aspects of development in Kenya, with resource mobilisation and allocation being its primary focus. It will seek to identify the factors that have promoted or impeded institutional development and performance. It will also assess, to the extent possible, the economic costs of institutional failure. The analysis will focus on three key aspects of institutional development, namely;

1. *Institutions as infrastructure for resource mobilisation and allocation.* The fiscal infrastructure and the financial system are the critical institutional mechanisms which mobilise and allocate resources. In Kenya, community resource mobilisation through the "Harambee", a prominent national institution, is also believed to contribute substantially to the resource mobilisation effort, although its quantitative significance is as yet to be well documented. Relatively high rates of physical and human capital accumulation, healthy tax revenues, sophisticated and sufficiently deep financial system would suggest that Kenya's resource mobilisation effort should have generated faster growth. This, then, points to the low productivity of capital due to inefficient allocation of these resources as the more important cause of the country's failure to sustain the initial growth momentum.

2. *Institutions as agencies of restraint.* The integrity and performance of the institutions of governance - the legal system in particular - supports growth by protecting property rights and enforcing public accountability. There is widespread perception locally and internationally that Kenya's governance institutions have recently become more capricious than most as indicated by the country being ranked among the most corrupt by several international surveys.

3. *Institutions as social capital.* Social capital is reflected in the vitality of a country's civic institutions or organised interest groups (such as industry associations, academic institutions and professional societies) and the nature of the interaction between the civic institutions and the state. Social capital can promote economic performance in various ways. It enhances trust, thus reducing agency costs and moral hazard risk between contracting parties such as between lenders and borrowers, firms and clients, and between the private sector and policy makers. Industry and professional networks also enhance intra-industry information flows which can facilitate faster diffusion of ideas and technology. The role of the church in Kenya's development is also crucial. In terms of financial resources the church rivals the government in many communities - it builds churches, hospitals and schools and is able to maintain standards.

Following independence in 1963, Kenya's government set an ambitious development agenda. Sessional Paper 10 of 1965 on African Socialism and its Application to Planning in Kenya spelled out the paramount goals of that development vision as,

- eradicating poverty, ignorance and disease
- growth with equity, and

- securing national economic independence, particularly through fiscal sovereignty and the Africanisation of the economy.

Kenya made very rapid gains on each of these fronts over the next two decades. To a large extent, these gains reflected successful institutional development, notably in the:

- Social services infrastructure (health, education)
- Agrarian institutions (KTDA, KPCU, KCC, agricultural extension services)
- Fiscal system (tax authorities, expenditure monitoring and control)
- Financial system

There is now broad popular and intellectual consensus that institutional capacity in the public sector has been eroded to the point where many organisations are a drain on the economy. It is less clear when, how and why the country's institutional development began to regress. Unless the factors which precipitated this erosion are understood, current and future reform initiatives risk being built on the quicksand of the same underlying causal processes that have led to the current institutional crisis.

2.3.2. Specific Policy Research Issues

Hypothesis

Kenya's development process lost momentum because of the failure, intentionally or otherwise, to acknowledge the ethnic nature of the conflict between redistribution and growth, with the subsequent failure to design a consensual and transparent institutional framework for articulating and arbitrating it. The conflict is manifested most prominently by the pervasive ethnic nature of the political discourse on public expenditure allocation. There is a widespread perception that socio-economic progress is a function of ethno-regional representation in public institutions. This is better expressed in the national political language as the "distribution of the national cake" or more explicitly, "it is our turn."

This analysis will argue that for high rates of economic growth to be sustainable in Kenya's political context, a process of institutionalising a consensual and transparent redistribution framework must proceed alongside other economic and political reform initiatives.

The specific issues to be examined are as follows:

1. Fiscal system
What are the causes of low public saving, poor public investment programming and high rates of project implementation failure?

2. Community resource mobilisation ("Harambee")
Why has there been poor accountability for the resources mobilised? What are the causes of the inadequate rationalisation, coordination and synchronisation with public investment programming?

3. Financial system
Is there inadequate investment credit? Are small and micro enterprises (SMEs) credit rationed? Is there inadequate agricultural credit and risk management? What is the significance and potential of the informal and semi-formal financial sector (SACCOs, NGO's)?

4. Institutions as agencies of restraint
What are the reasons for inadequate audit and judicial independence and poor corporate governance in the state enterprise sector? What has been the role of organised interest groups (civic lobbies) as internal agencies of restraint and the role of external actors (donors and aid conditionality) as external agencies of restraint?

5. Institutions as social capital
What explains the lack of institutional capacity of industry and professional organisations (e.g. KAM, KNCCI)? Why has there been inadequate private sector participation in the policy process?

2.3.3. Research Methodology

The institutional dynamics of development is a broad and complex subject, which is difficult to examine exhaustively in the present study. Additionally, relevant data for institutional analysis are scarce. Therefore, the study will seek to be illustrative and suggestive, rather comprehensive. The research instruments to be used will include:

1. Structured and unstructured interviews with key actors including key policy makers, current and past members of the Public Accounts Committee, and officials of industry and professional organisations.
2. Quantitative analysis will include an analysis of trends in the sectoral and regional distribution of public investment; analysis of available data on national 'harambees'; survey on the growth and financial structure of small and micro enterprises (jua kali sector); analysis of the Auditor General's reports; and factor analysis of the composition of the boards of directors and chief executives of public enterprises.
3. Case Studies. For each of the key aspects of institutional development identified, at least one successful and one unsuccessful detailed case study will be developed.

2.4. Production, Productivity and Competitiveness

2.4.1. Introduction

Competitiveness has a bearing on returns to investment in general and the ability to sustainably participate in the external markets. Both are crucial for economic growth and are inter-linked. An environment that offers the greatest opportunity for participating in the external markets is also often attractive to foreign investors who have a global outlook. From a Kenyan perspective, the case for outward orientation is very strong, since the domestic market is too small to sustain a fast rate of growth. Maintaining an expressly outward orientation can therefore be considered a precondition for restarting and sustaining economic growth.

2.4.2. Specific Policy Research Issues

This component of the country study will explore factor productivity with a particular focus on labour productivity[2], indirect production costs, and existing trade promoting interventions. It will offer policy suggestions for increasing Kenya's competitiveness as a location for production. Specifically, it will examine the incentive structure affecting business and labour, and highlight the impediments on enhanced level of international competitiveness.

a. Productivity of labour

The productivity of labour depends on its quality and the incentives for redressing the disutility suffered in working for others. The quality of labour is in turn composite as it is affected by educational attainment and types, health status, attitude to work, motivation for self-improvement, perceptions about employment opportunities, the degree of respect for property rights and a host of other factors. Improvements in the quality of labour may result from opportunities for the continuous upgrading and reshaping of skills. The development literature underscores the critical role played by appropriate skills in tipping the balance towards exports of manufactures[3].

The return to effort is in turn determined by the structure of both the product and labour markets, labour legislation and the extent of its enforcement, and union activity. Productivity and wage rates also determine unit labour costs, which affects the degree of competitiveness.

Issues to be examined include the observed levels of labour productivity, opportunities for responding to skills needs at the enterprise level, and the structure of labour costs. The

[2] This choice of focus is based on observations which suggest that interplay between entrepreneurship and the deployment of labour is probably what unlocks productive potential including that which may be embodied in other factors of production.

[3] The basic hypothesis is that countries with low skill to land ratios generally tend to export primary products while those with high skill to land ratios export manufactures. See also Owen, T. and A.Wood, 1995. "Export oriented industrialisation through primary processing" Working Paper No.19, Institute of Development Studies, University of Sussex.

significance of non-wage costs of labour (supervisory, pilferage and anti-theft expenditures, illnesses-HIV and absenteeism) and their impact on the overall labour costs are also of policy interest. The analysis will also address the impact of labour legislation and union activity on the structure of the labour market and costs, and the effect of the current education policy on labour productivity.

An analysis of the incremental capital output ratios and other measures of the efficiency with which capital is used will be undertaken to complement the analysis on labour productivity.

b. Infrastructural deficiencies.

An adequate supply of reliable infrastructure obviates unnecessary working capital and inventory, reducing operating costs and permitting a timely response to market signals, all of which increase industry and national competitiveness. When enterprises which make intensive use of infrastructure, accept the deterioration in such services as part of the environment in which they have to operate, they either relocate, modify the structure of their activities, provide their own infrastructure services to the extent possible (e.g., diesel generators for electricity) or simply wait to die. Self provision of infrastructure, often a common strategy by enterprises determined to stay in production, generates inefficiencies related to scale diseconomies. Under controlled import-substituting regimes, it was easier to accommodate failures in public infrastructure by either absorbing or passing on the additional costs resulting from such self-provision[4]. However, in a liberalised environment, infrastructure self-provision simply makes production less efficient and less competitive.

How do Kenyan enterprises respond to deficiencies in infrastructure services and how significant are the costs imposed by such deficiencies? What contributions have market and policy failures and legislation made to infrastructure deficiencies? What policy interventions would ensure sustainable provision of infrastructure services to reduce the costs of doing business in Kenya?

c. Trade incentives and revealed comparative advantages

Kenya's development landscape is dotted with an assortment of incentives designed to attract and direct investment towards specific economic activities. It is important to examine how successful such incentives have been in eliciting an appropriate response. It is possible that these incentives are being implemented against a tide of unstated but unassailable disincentives, so that the outcomes do not meet expectations. In other cases, the incentives may not reinforce the dynamics of comparative advantage and are therefore not productive.

This analysis will examine the trade support packages in the context of Kenya's assumed and revealed comparative advantage and suggest ways of targeting appropriate incentives to promote competitiveness through fuller exploitation of this advantage. Of particular interest is the nature

[4] An aspect of the controlled environment was administered prices based on cost-plus principle, permitting inclusion of the costs of self provision in the computation of periodic price proposals.

of the private sector response elicited by such incentive packages and the necessary modifications for promoting further response.

2.4.3. Research Methodology

The growing volume of research on production relations in Kenya's manufacturing sector will be exploited to inform the analysis on productivity and costs[5]. Use will be made of existing firm level surveys, supplemented by a new survey, to fill gaps in the information. Such gaps may relate to the less obvious costs of production; enterprise responses to, and the costs of, deficiencies in infrastructure; and to trade support packages. Firm level data will be complemented with time series information, particularly in analysing incremental capital output ratios and revealed comparative advantages. Case studies of successful and unsuccessful subsectors will also be analysed in order to draw out specific lessons and polices that can be applicable to other sectors of the economy.

A combination of methods will be employed in analysing the information; quantitative analysis for estimation of factor productivity and returns to scale; discrete choice analysis for enterprise response to deteriorating infrastructure; and response to and opinions on support programmes. Descriptive analysis of unit factor costs and revealed comparative advantages ratios.

2.5. Cross-cutting Themes

In carrying out the Kenya Country Study, issues will arise which cut across the thematic boundaries. Examples of such issues and questions include:

1. Institutions/Macroeconomic Management:
What pressures have influenced the political commitment to Kenya's economic reform program? What has been the role, if any, of external agencies in securing the independence of the Central Bank of Kenya? What are the likely implications of this independence on future monetary policy making? Can such independence be extended to other organisations (e.g., the Kenya Revenue Authority or Anti-Corruption Authority)? What ethno-regional or sectoral pressures have influenced the management of Kenya's fiscal policies?

2. Macroeconomic Management/Production, Productivity and Competitiveness.
What are the effects of monetary and fiscal policies on the cost structure and competitiveness of domestic enterprises? What level of interest rates will encourage greater domestic investment in irreversible fixed assets and attract long term foreign private capital? How does the volatility of interest and exchange rates affect the behaviour of the domestic private sector? Can the need for high tax revenues be reconciled with a tax structure that is favourable to private enterprises?

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[5] See, for example, Economics Departments, 1994. *Limitations and Rewords in Kenya's Manufacturing Sector: A Study in Enterprise Development* University of Gothenburg, Sweden and University of Nairobi, Kenya.

3. Institutions/Production, Productivity and Competitiveness:
Has Kenya's commercial legislation been consistently applied? If not, what has been the effect of this on corporate behaviour? Is there a case for greater participation by Kenya's political leadership in supporting the country's exports? How would this support be implemented? Is Kenya's export incentive regime politically neutral and consistently implemented?

The process of research and analysis will involve close interaction between the principal (thematic) researchers to ensure that these issues are examined in a consistent and complementary way. Such interaction will be accomplished as follows:

1. The researchers will become familiar with these and other cross-cutting issues. They will also identify new cross-cutting issues as they carry out the analysis in their particular thematic areas and communicate these to the researchers examining the relevant themes.

2. Researchers will then jointly examine the cross-cutting issues, proposing insights from their own thematic areas and working together to develop a coherent analysis of the issues.

3. The cross-cutting issues will also be communicated to the researchers from the EAGER/PSGE consortium member institutions (HIID, IRIS, AIRD, Howard University) who will examine them from a broader cross-country context, drawing on the research from the other country studies as well as their international research experience.

3. Organisation of the Kenya Country Study

3.1. Approach to the study

The team for the Kenya country study has been organised into the following four components:

1. Research Supervision Committee (RSC)
2. Study Coordinator
3. Principal Researchers
4. Resource Persons

1. Research Supervision Committee
The purpose of the Research Supervision Committee (RSC) is to maximise the probability that the study's findings will influence national policy making in a direction that will promote economic growth with equity. In discussing the scope of work, progress report and draft final report with the research team, RSC members will reflect their perception of the questions that are most in need of a research approach to derive answers that can usefully guide policy making. They will advise on which policy departures are most likely to succeed in promoting growth with equity. It is also intended that RSC members will facilitate contact between researchers and policy makers and stakeholders. A key role for RSC members at a study's conclusion is to advise

on a program of dissemination to be conducted in a subsequent phase of the EAGER/PSGE project.

2. Study Coordinator

The principal role of the study coordinator is to manage the research process. The coordinator has already initiated the study by proposing members for the RSC, constituting a team of principal researchers and spearheading the development of the scope of work. In addition to managing the research process, the coordinator will make technical contributions to the analysis, offer policy guidance as is relevant and appropriate and, in consultation with the RSC and HIID, ensure that the output meets the highest technical standards.

3. Principal Researchers

It is proposed that each thematic area of research be undertaken by a principal researcher. Three principal researchers have been selected after careful consideration of the economic research capability existing in Kenya. The proposed researchers were selected on the basis of two important criteria; (i) their technical research ability, and (ii) their policy intuition on the practical economic growth challenges facing the country. The principal researchers have contributed significantly to the development of the research issues for each of the thematic areas, and they will be responsible for carrying out the analysis. Specific tasks include:

- Reviewing and summarising the existing literature on Kenya's economic growth experience.
- Developing (testable) hypotheses for the thematic areas in Kenya's context.
- Developing survey and data collection instruments where appropriate.
- Conducting interviews with economic agents (private sector) and policy makers.
- Developing original interpretations of Kenya's economic performance and proposals for new policy departures with the potential for restarting and sustaining growth.
- Preparing the paper on their specific thematic areas.

4. Resource Persons

The proposed resource persons will work closely with the principal researchers, particularly in carrying out the literature review, the interviews/survey with key economic agents and in data collection and compilation. In addition, they will research and develop specific case studies to illustrate the three themes.

3.2. General Research Methodology

Section 2 has highlighted the research methods which will be applied to each of the thematic areas. However, the following general methodology will be used in the analysis of each theme:

1. Literature review. Drawing on the extensive official (government and donor) and research literature, this review will identify and summarise the principal elements of the economic policy regime that has prevailed in Kenya over the last two decades. It will also highlight the

country's experience with reform, noting and accounting for episodes of reform policy reversal or abandonment.

2. Interviews with key economic agents and policy makers. Researchers will talk to, and analyse the actions of, key domestic and foreign investors and senior policy makers to develop a clear picture of what they perceive to be the major constraints to rapid and sustained economic growth rates in Kenya, and the appropriate reform measures necessary to remove these constraints.

3. Data compilation and analysis. It is anticipated that the research in all three thematic areas will have significant data requirements. While the macroeconomic analysis will make use of secondary data sources, there will be a need to collect primary data using interviews and structured surveys in both the institutional analysis and the analysis of Kenya's production, productivity and competitiveness.

4. Report preparation. Drawing on the information from the literature review, interviews with principal economic agents and analysis of available data, the researchers will prepare detailed reports on their findings in each theme. The first report, produced approximately two calendar months from the start of the research, will review work in progress, highlight key issues, relevant literature and experience, tentative findings and future research and anticipated results. This progress report will be discussed with senior policy makers in the mid-stream country seminar.

   A draft final report, prepared after a further two or three months of research, will summarise principal findings and include proposals for new growth-oriented policy measures. This will be presented and debated at an Africa-wide conference. The draft final report will also be discussed with Kenya's policy makers, following which the coordinator, principal researchers and HIID's principal investigators will compile a final report in the form of a publishable volume.

4. Proposed Kenya Country Study Research Team

The composition of the research team for the Kenya Country Study is presented below. Brief summaries of key qualifications has been provided for the study coordinator, the principal researchers and the resource persons.

A. Research Supervision Committee

1. Jimnah Mbaru, Chairman, Nairobi Stock Exchange
2. Graham Glenday, Senior Advisor, Ministry of Finance (Kenya)
3. Harris Mule, Economist and Policy Analyst (former Permanent Secretary, Ministry of Finance and Planning, Kenya)

B. Country Study Coordinator

1. Ngure Mwaniki, Managing Director, M.A. Consulting Group

Mr. Mwaniki, an Economist, is a graduate of Harvard University, USA (M.P.A.), the University of Colorado (Dip. in Econ.) and the University of Nairobi (B.A). Mr. Mwaniki is the founder and Managing Director of the M.A. Consulting Group. In this capacity he has been responsible for the design, methodology and directorship of over 75 studies and projects in the region during the last 14 years. The majority of the projects were funded by well known development organisations such as the EU, World Bank, ODA, ADB, APDF, IFAD, USAID, UNDP and the Economic Commission for Africa, as well as NGOs, governments and other public sector organisations in the region. Examples of assignments completed include: Project Director on the commercial restructuring of the National Cereals and Produce Board (NCPB); Co-Team Leader on a study to restructure the Kenya Tea Development Authority (KTDA) and other Tea Sector Institutions; Senior Economist on a study to restructure the operations of the Kenya Ports Authority (KPA); Team Leader for a study to improve the Accounting and Financial Management of Uganda's parastatals; Review of the Management Consulting Capacity in the Eastern African countries; Senior Economist on a major study to review the investment climate in Kenya; Senior Economist on a study to compare the economic competitiveness of eight sub-Saharan African countries; Senior Consultant on a study to review the investment climate and opportunities in the Eastern African region for a regional development bank and Consultant to a Commission set up by H.E. the President of Kenya to examine broad issues of economic policy and management. He has undertaken consultancy assignments in Kenya, Uganda, Tanzania, Malawi, Ghana, USA, Nigeria, and Ethiopia.

C. Proposed Principal Researchers

1. Njuguna Ndung'u (Macroeconomic Management)

Dr. Ndung'u, a macroeconomist, obtained his doctorate from the University of Gothenburg, in 1993. He has extensive research experience in macroeconomic management issues in developing countries. Selected publications in this field include:

- The Impact of Financial Liberalisation on Savings, Investment, Growth and Financial Development in Anglophone Africa, (AERC Senior Policy Seminar II, African Development Review, Vol 9 No. 1, June 1997, pp 20-51)
- Price and Exchange Rate Dynamics in Kenya: an empirical investigation (1970-1993). (AERC Research Paper 58, March 1997)
- Inflation in Kenya: an empirical analysis (Institute of Development Studies, University of Nairobi, Discussion Paper No. 514, November 1996)
- An Exchange Rate Pass-through Equation for Kenya (1970-1993) (African Journal of Economic Policy, Vol 3 No. 1, June 1996)
- Government Budget Deficits and Inflation in Kenya: an empirical investigation (African Journal of Economic Policy, Vol 2 No. 2, December 1995)

Selected forthcoming publications analyse the impact of debt overhang on economic growth in sub-Saharan Africa; exchange rate management and macroeconomic policies in Kenya, and the effects of risk, uncertainty and debt overhang on private investment in sub-Saharan Africa. Dr. Ndung'u has also consulted extensively for the World Bank, USAID and UNDP/UNCTC. He was recently a researcher and visiting scholar at the International Monetary Fund and is currently a lecturer at the University of Nairobi.

2. David Ndii (Political and Institutional Analysis)

David Ndii is a public policy analyst with academic training in economics. He is currently completing his doctorate in economics at Oxford University with a dissertation on the dynamics of savings, financial development and capital accumulation. He worked for three years as an economist at the World Bank's Regional Mission in Eastern Africa (1990-93); and subsequently on a broad range of short term projects for the Bank in Washington. He has excellent knowledge of eastern African economies, politics and institutions and his major professional and research interests are in the political economy of development, finance and international macroeconomics.

3. Harris Mule (Political and Institutional Analysis)

Mr. Mule is a graduate of Harvard University (MPA, Development Planning) and the University of Denver (MA, Economics). He has worked for over 20 years in Kenya's civil service, including the positions of Chief Economist and Permanent Secretary in the Ministry of Finance and Planning. Mr. Mule has extensive experience in institutional analysis. He has provided high level consultancy services to, among others, the African Development Bank on a policy framework for the governance of the Bank; the African Capacity Building Foundation (ACBF) in formulating a strategy for capacity building in policy analysis and economic management in several Africa countries; and the Eastern and Southern African Debt and Reserve Management (ESAIDARM) on debt reserve management strategies for the region. He also advises the World Bank on its operations in Africa and was recently the Chairman of the Working Party on the Bank's instruments and policies and the impact on capacity building in Africa. Mr. Mule is on the Board of Directors of several policy research institutes, including the Institute of Policy Analysis and Research (IPAR) in Kenya of which he is Chairman, and the International Food Policy Research Institution (Washington, USA).

4. Peter K. Kimuyu (Production, Productivity and Competitiveness)

Professor Kimuyu obtained his doctorate from the University of Nairobi in 1988. He has since then undertaken extensive research, with special emphasis on applied microeconomics. Selected work in this field include:

- Enterprise Attributes and Corporate Disputes in Kenya (IPAR Discussion Paper, No 1, 1997)
- Productivity and Technical Efficiency in Electricity Generation: a Third World Comparison (with others, under production)

- Rotating Savings and Credit Organisations in East Africa (submitted to World Development)
- Waste Management Deficiencies and Self-provision Incidence in Kenya Manufacturing (accepted for publication in the African Urban Quarterly)
- Labour and Labour Markets (with others, in Pinckney, T.C. (ed.), Policy and Rural Development: Two Communities in East Africa. Williams College, Williamstown, 1994)

Other areas of Professor Kimuyu's research include energy economics, infrastructure provision and enterprise development.

D. Research Assistants

1. Aidan Eyakuze (Macroeconomic Management)

Mr. Eyakuze of the M.A. Consulting Group, has an MA (Economics) from Simon Fraser University and a B.Sc. (Hon, Economics) from Trent University, both in Canada. He has worked as an economist in a number of areas, including policy analysis, corporate strategy development in both the public and private sector, baseline survey design and implementation and impact assessment in agriculture, public enterprise reform and private sector development.

2. John Githongo (Political and Institutional Analysis)

Mr. Githongo, a political analyst and journalist, has a B.Sc (Hons) in economics and philosophy from the University of Wales. He recently completed a study of the land tenure systems in Rwanda and Tanzania, and a study on land related conflict in Kenya, both for USAID. His consultancy work has included an analysis of Kenya's District Health Management Boards; facilitating a strategic planning retreat for the Public Law Institute and training workshops for public health officers among others. As a journalist, Mr. Githongo regularly contributes articles in political analysis to The Economist/Economist Intelligence Unit, the Financial Times of London, Africa Analysis and The EastAfrican, among other publications. In 1995, he was awarded the Third Prize in the Professional Category of the 'African Journalist of the Year.'

3. John Kashangaki (Production, Productivity and Competitiveness)

Mr. Kashangaki, of the M.A. Consulting Group, has an MPA (Economics/Public Policy) from Princeton University's Woodrow Wilson School of Public and International Affairs, and a B.Sc. (Engineering) from the University of Michigan. His key qualifications include the successful completion of over twenty consulting projects in private enterprise development; direct experience in developing policy and institutional frameworks for the manufacturing sector in the east African region; and providing advice to USAID on the development of a five year private sector development assistance strategy. He has also successfully designed and implemented numerous private sector surveys including a review of the investment climate in Kenya, an analysis of the growth of private businesses in Tanzania and a comparative cost of production analysis for East Africa.