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EXPORT ENTERPRISE SUPPORT

Project Concept Paper

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For:

Southern African Regional Program (SARP)/USAID Zimbabwe

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I. SUMMARY RECOMMENDATION

The U.S. Agency for International Development Mission to Zimbabwe (USAID/Zimbabwe) requests approval to proceed with development of an Export Enterprise Support (EES) Project (690-0245) to be funded under the Southern Africa Regional Program (SARP). The proposed project is to be carried out over a four-year period and will require $30.0 million in Southern Africa Development Assistance grant funds. The project is designed to enhance the economic development of the member states of the Southern Africa Development Coordination Conference (SADCC) by increasing exports from the private sector.

II. SUMMARY PROJECT DESCRIPTION

The goal of the project is to increase economic growth through expanded exports in SADCC countries. The project's purpose is to improve the policy and regulatory environment for exports and to increase private sector exports. By improving the policy environment and expanding exports, the project will achieve increased foreign exchange earnings, income, and employment in the region. Corollary benefits include a strengthening of private sectors, the introduction of market-driven policy strategies, and increased economic self-sufficiency, all of which contribute to sustained economic growth and development.

This project addresses regional trade issues in SADCC. It assists SADCC in implementing its trade strategy through selective activities at the regional level and through member country activities that have regional coherence and justification.

The project goal and purpose will be pursued through two project components. Policy analysis and implementation assistance will be provided to private sector and government organizations at both the regional and national levels. This component will increase the base of information, analytical capabilities and communication capacities necessary to support productive dialogue, which in turn leads to the design and implementation of policies, regulations, and procedures conducive to export growth. Export promotion information and assistance will be provided to exporters, both directly and through supporting business and government organizations, again at both the national and regional levels. This component will enhance exporters' access to information (market intelligence, export/import requirements, joint venture opportunities, etc.) and technical services which are critically important inputs for initiatives to stimulate nontraditional exports.

Subcomponent activities were identified by SADCC, USAID Missions and the design team, and then were subjected to a rigorous screening process. Only those activities which met predetermined selection criteria have been included. The activities of the EES project constitute Phase I of what is anticipated to be long-term export development assistance in Southern Africa.

It is planned that the authorized funds will be obligated through a written agreement with the Government of Tanzania (GOT) in its capacity as the host country of the SADCC Sector Coordinating Unit for Trade and Industry. The Agreement and a side letter, as necessary, will establish that a large amount of the funds so obligated will be committed to a competitively bid direct AID contract with a Harare-based central project contractor, which will provide administrative and technical services. Buy-ins to AID Central and Regional Bureau contracts also are planned in order to provide access to additional technical assistance resources.

Regional project activities to be supported by the project have been identified in collaboration with the SADCC Secretariat in Gaborone and the Sector Coordinating Unit for Trade and Industry. Specific project activities in each country have been identified by or in close collaboration with USAID bilateral Missions, and screened according to an established set of regional selection criteria.

III. PROGRAM FACTORS

A. CONFORMITY WITH SADCC MEMBER COUNTRY POLICY AND STRATEGY

SADCC. The Southern Africa Development Coordination Conference (SADCC) was established in 1980 to pursue three main objectives: (1) reducing economic dependence; (2) improving regional cooperation; and (3) mobilizing indigenous and donor resources to address common development constraints. During its initial five years of existence, SADCC focused heavily on rehabilitating and extending transportation and communications infrastructure. The view of SADCC, as expressed in the Overview Paper for the 1987 Consultative Conference, was that

". . . there was little point in concentrating attention on trade enhancement when levels of production were so low and the main constraints to trade were of a physical nature."

In addition to infrastructure development, SADCC strategy emphasized rehabilitation and coordination of regional industrial capacity and intra-SADCC trade, aimed at achieving economic independence and economies of scale, utilizing regional production capacity and markets.

Throughout the 1980s, SADCC's growth and trade performance has been disappointing, due to lack of economic complementarity, foreign exchange shortages, inefficiencies of state owned or operated enterprises, insufficient transportation, small markets and other factors. Recognition of this poor performance has led in recent years to dramatic changes in SADCC attitudes toward and strategies for export development. The culmination of a series of actions and events (described in further detail in Annex G) was the development of a "framework" for new approaches presented in the 1989 SADCC Annual Conference Overview Paper on "The Productive Sectors: The Engine of Growth and Development."

The Overview Paper proposes the relaxation of constraints to investment, both domestic and foreign, through favorable investment codes, improved macro-economic management, reduction of price and administrative controls, and encouragement of cross-border and joint venture investments. Proposed trade expansion initiatives include trade promotion, export revolving funds and credit facilities, and cross-border investment facilities. The critical element expressed in this shift is recognition that private enterprise is essential to resource mobilization and economic growth, and that the private sector should engage in productive dialogue with SADCC governments to seek market oriented trade policy strategies. An additional change has been the acknowledged need to pursue SADCC export markets outside the region, and not just intra-regional markets.

The proposed EES project is fully consistent with current SADCC policy and strategy. SADCC member countries are now addressing policy issues related to trade, investment and entrepreneurship, and so the project coincides with a "window of opportunity" for developing market-driven approaches to achieve stronger export performance. In addition, the project contributes directly to SADCC's basic goals of attaining greater economic independence and regional cooperation, and reducing development constraints through the mobilization of indigenous and donor resources. Indications of SADCC's receptivity to private sector export enhancement include the formulation of Business Councils, a new draft Industry Strategy, and the development of a Program of Action for the trade and industry sector.

SADCC Member Countries. In most nations in Southern Africa, an ongoing policy reform process has already yielded substantial improvements in economic activities and the viability of development approaches. Driven by domestic and external realities and the need to reduce demands on scarce resources in an environment of slow growth and decreasing assistance flows, governments in the Region are tackling difficult issues and problems. Annex J provides a review of the current status of policy dialogue and reform in each nation in the region. This section offers a brief summary of that analysis from a regional perspective.

A distinction may be drawn between Botswana, Lesotho and Swaziland, which are especially dominated by South Africa geographically and economically, and the other SADCC countries of Malawi, Mozambique, Tanzania, Zambia and Zimbabwe.

The first three countries share the common characteristic of a unique geographic dependence upon South Africa. This emanates from membership in the Southern African Customs Union and the Common Monetary Area (except Botswana), common boundaries with South Africa, extreme trade dependence upon South Africa, a significant number of guest workers in mining, and ultimately a direct linkage to South African economic conditions. All three nations face limited economic resource endowments and prospects for diversification. Only Botswana is able to conduct an independent monetary policy, since it withdrew from the Rand Monetary Area in 1975, and its degree of policy flexibility is limited. The external policies and borders of these nations are relatively open, and so access to productive resources is greater than that of other SADCC countries. They also face less difficult financial constraints than do other SADCC members. On the other hand, these countries are far less able to "de-link" their economies from South Africa, and possess much lower levels of indigenous resources on which to build economic independence.

All of the other members of SADCC have undertaken fundamental economic reforms within much more stringent financial conditions. Reforms have generally included exchange rate adjustments, more prudent management of interest rates and government budgets, divestiture efforts, and price reforms. Collectively, these changes reflect a reduction in direct government intervention and a concomitant rise in the role of market prices and forces in mobilizing and allocating resources. Most reforms have been initiated with participation of multilateral and bilateral donors. Only in the case of Zambia has there been a clear repudiation of this reform agenda and a return to heavy government direction of all aspects of the economy.

The widespread reform movement described above is marked by substantial variation according to several factors:

- There are considerable differences in progress achieved to date and in the severity of current economic problems. Malawi has been seeking to change economic policies since the mid-1980s. Mozambique and Tanzania, faced with severe economic dislocations, have more recently undertaken drastic and fundamental changes.

- The need for infrastructure rehabilitation will act as a severe barrier to aggregate economic reform in nations affected by a long history of economic stagnation and those affected by insurgency.

- Reform is inherently threatening to traditional vested interests, including import substitution industries, which will continue to seek to block or delay policy changes.

Notwithstanding these factors, the overriding realities of the 1980s and 1990s -- including limited growth in global trade, relatively stagnant commodity prices, strong international competition for markets and investment funds -- provide SADCC countries with no viable alternative to the continued pursuit of economic reform. This set of "base case" assumptions is broadly acknowledged in the region, and all governments seek strategies to increase the competitiveness of their economies and to expand export earnings, particularly in area of nontraditional products with higher amounts of domestic value added and consequent benefits to the national economy. The proposed project is intended to contribute to efforts to achieve those ends, and hence is consistent with the national objectives of the individual host countries.

B. RELATIONSHIP TO RDSS AND A.I.D. POLICY AND STRATEGY

RDSS. A strategic objective of the 1991-1995 RDSS is to stimulate private sector exports:

> "The U.S. program to stimulate trade and entrepreneurship will . . . encourage and support actions leading to increased foreign exchange earnings through trade in all directions and will promote wider private sector participation in market activity."

The RDSS stresses that SADCC must expand trade with all nations, within and outside the region, so that exports can serve as an engine of growth. The expanded production capacity, income, foreign exchange, and transportation linkages derived from this growth will in turn strengthen the basis for intra-regional trade. The RDSS notes that SADCC countries vary considerably in economic conditions, policy stances, and requirements for export development. The RDSS calls for assistance which supports viable, profit-making ventures of the private sector, and for governmental and private sector leaders to engage in productive dialogue on policies, regulations and procedures which act as constraints to market-oriented development.

The proposed project is fully consistent with and contributes directly to RDSS goals and strategy. The central goal of the project is to expand private sector exports, both within and outside the region. The project's implementation plan, described below, combines the strengths of a regional approach with the requirements for tailored initiatives in each country. The principal beneficiaries of the project are private sector exporters, both directly and through policies adopted and services offered by government entities. Finally, the project seeks to reduce export constraints erected by inappropriate policies and lack of access to information and other ancilliary services.

A.I.D. A.I.D. policy encourages developing countries to utilize international trade as a key instrument for achieving broad-based, sustained economic growth. As stated in the July 1986 Trade Policy Paper, A.I.D. also encourages nations to place greater reliance on domestic competitive markets that support trade policies. A.I.D. policy also supports the adoption of "outward-looking" trade strategies which replace or at least supplement import substitution approaches. Development and the National Interest: U.S. Economic Assistance into the 21st Century, a report by the Administrator for the Agency for International Development, stresses the need for market oriented strategies for creating an environment for generating foreign exchange earnings in an era of shrinking donor assistance, large debt servicing requirements, and exchange needs to finance inputs for expanding productive capacity. Without these resources it is impossible to achieve sustainable economic growth, generate employment opportunities, and improve the living standards of the poor majorities within countries.

As stated in the 1985 Policy Paper on Private Enterprise Development, A.I.D. policy advocates a reduced government role in economic activities and the freeing of the creative instincts and energies of private individuals and organizations. This policy stresses mobilizing private sector resources, increasing the contribution of private production and employment, and introducing market incentives and rewards (rather than administered signals) for productive activities.

Export Enterprise Support (EES) Project

Annex F:

U.S. A.I.D. Trade and Entrepreneurship Policy
for Southern Africa

May, 1984: Southern Africa Regional Development Strategy Statement

The 1984 RDSS justifies assistance to Southern Africa politically as a visible means of supporting an "even-handed policy of constructive engagement" and economically as a means of addressing some serious development constraints best dealt with on a regional basis. In addition, U.S. support for SADCC is justified as a way to show Southern Africans a U.S. commitment to broadening their regional economic base and 'ensuring a stronger, more effective organization for regional development and coordination. It then presents details of a U.S. A.I.D. Southern African regional program focused on agricultural research and training, manpower and education, transforation, and support for SADCC as a regional organization. Such support is seen as a complement which directly supports the U.S. A.I.D. bilateral strategies in the seven Southern African states.

Trade

Only indirectly is trade development addressed by the RDSS. It does recognize that the major force binding Southern African countries together, and therefore justifying a SADCC regional organization and regional program by A.I.D., is economic dependence on and economic dominance by South Africa. In addition, common economic problems lend themselves to joint resolution. Taking the cue from SADCC development priorities, A.I.D. efforts are therefore focused directly on agriculture, transportation,and manpower/human resources.

There is recognition that opportunities exist for expanding intra-SADCC trade, but that several factors inhibit its expansion:

> "Constraining more intra-SADCC commerce are the traditional trade patterns developed during the colonization periods, including the orientation to primary product exports. Also limiting Southern Africa commerce are existing trade relationships with the RSA and the readily available trade financing offered by the Republic. Virtually no such patterns or facilities exist for trade between the developing countries of SADCC. Larger market size, low wages and government price supports and export

subsidies give RSA producers a unique competitive advantage in the region. In addition, transportation and communication routes have been designed to encourage traditional patterns of primary product exports, particularly to the former colonial nations and to the RSA.

"Another central factor contributing to the minuscule intra-regional trade is the lack of financing and export credit. The international commercial banking system tends to provide credit for commodities well established in world markets, where there is less financial risk. Also policies in the SADCC countries tend to limit the financing of intra-regional trade. High tariffs between the countries constitute one such disincentive. Foreign exchange constraints facing most Southern African nations further limit trade. The East and Southern Africa Preferential Trade Agreement (PTA),to which most SADCC states are signatories, will have little impact unless business can obtain export financing to move their goods and to buy from other countries."[1]

Anticipating future attention by SADCC to trade development issues, the RDSS takes an initial step in that direction through general support for the SADCC Secretariat and network of sector operations. Thus, the RDSS says that such support to SADCC ". . . will reinforce and promote policy dialogue in such areas as agricultural pricing, farm price incentives, trade development, harmonization of transportation fees, taxes, and regulations, and manpower development."[2]

Also the RDSS recognizes that as the Southern African regional approach to development proceeds, trade will be an"obvious" area of regional priority, even though initially it received insufficient attention. In this regard the RDSS says of this new area for priority attention:

"Trade may in time offer opportunities for regional program involvement. The challenge to the region is to find ways in which to expand these opportunities. . . . However, as we have learned from the past, a cautious approach is likely to produce more lasting commerce within a region. Therefore, other than studies, no specific regional interventions are proposed. AID will continue to monitor the proposed PTA financial clearinghouse to see if it is an

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[1] U.S., Agency for International Development, <u>Country Development Strategy Statement - FY 1986: Southern Africa</u> (Washington D.C.: U.S. A.I.D., May, 1984), p. 11.

[2] U.S. A.I.D, <u>Country Development Strategy Statement - FY 1986: Southern Africa</u>, p. 46.

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appropriate instrument for stimulating regional trade. Transportation is the most important investment AID can now make to promote regional commerce at this stage."[3]

Industrial Development

The thrust of A.I.D. support in Southern Africa as defined by the RDSS excluded any direct support for industrial development, even though SADCC had a designated Industrial Sector with responsibility assigned to Tanzania. The RDSS argues that improved transport facilities and a gradual reduction of dependence on South Africa transport, production, investment and employment would stimulate eventual industrial development possibilities. The legacy of colonial dependence remains so strong and the period of political independence for Southern African countries has been so short that any industrial development efforts supported by A.I.D. would be premature. Put differently, there are pre-requisites to industrial development which take priority.

The position that basic problems constrain development generally and industrial development in particular are seen in the following RDSS statement which implies also that trade stimulation should come before support for industrial development:

> "Constraining more intra-SADCC commerce are the traditional trade patterns developed during the colonization periods, including the orientation to primary product exports. Also limiting Southern Africa commerce are existing trade relationships with the RSA and the readily available trade financing offered by the Republic. Virtually no such patterns or facilities exist for trade between the developing countries of SADCC. Larger market size, low wages and government price supports and export subsidies give RSA producers a unique competitive advantage in the region. In addition, transportation and communication routes have been designed to encourage traditional patterns of primary product exports, particularly to the former colonial nations and to the RSA.
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> "Another central factor contributing to the minuscule intra-regional trade is the lack of financing and export credit. The international commercial banking system tends to provide credit for commodities well established in world markets, where there is less financial risk. Also policies in the SADCC countries tend to limit the financing of intra-regional trade. High tariffs between the countries

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[3] U.S., Agency for International Development, Country Development Strategy Statement - FY 1986: Southern Africa, p. 48.

constitute one such disincentive. Foreign exchange constraints facing most Southern African nations further limit trade. The East and Southern Africa Preferential Trade Agreement (PTA), to which most SADCC states are signatories, will have little impact unless business can obtain export financing to move their goods and to buy from other countries."[4]

January, 1987: An Initiative for Economic Progress in Southern Africa

The 1986 U.S. Comprehensive Anti-Apartheid Act, P.L. 99-440, called for (in Section 505) an initiative aimed at accelerating the economic reform and development of Southern Africa. The staff of the A.I.D. Southern Africa Regional Program in Harare, Zimbabwe drafted such an initiative as a supplemental budget request of $36 million in FY 1987 and $57 million for FY 1988 (with future years funding to be requested in the established budget cycles). This reveals the evolution of thinking on trade development as a priority area of attention in the region.

Conceived as a multi-year economic assistance program in addition to the continuing regional and bilateral assistance efforts in Southern Africa, the initiative was viewed as helping countries of the region improve transport and expand trade and private investment. Thus:

"It is proposed that the U.S. support:

- -the regional initiative to rehabilitate transport and port facilities,
- -reform of economic, trade and monetary policies to attract foreign investment to the region, and
- -mechanisms to facilitate trade among the southern African countries and between them and the rest of the world.:"[5]

The proposed initiative focused on what were viewed as the "key" macroeconomic constraints to growth and economic vitality in the region. It argued that transport, trade, and reorientation of national policies to support a greater role for the private sector were interlinked and complementary. As a result:

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[4] U.S. A.I.D., Country Development Strategy Statement - FY 1986: Southern Africa, p. 11.

[5] U.S., Agency for International Development, An Initiative for Economic Progress in Southern Africa (Washington D.C.: U.S. A.I.D., January, 1987), p.1.

". . . when the region's transportation network is capable of efficiently moving trade goods within the region and overseas, mechanisms to promote trade, as well as policies conducive to increased market-led economic activity and production, will also be in place."[6]

The resulting benefits, as described by the Initiative, focus largely on benefits from improved trade:

"In the short-term, this U.S. initiative will help southern African countries to:

-ensure that existing economic reform measures can be continued and sustained;
-provide more efficient, cost effective transport routes for vital imports and exports;
-save on import bills (through reduced transport costs and cheaper imports from the regional market), thereby making scarce foreign exchange available for other urgent needs;
-expand export markets;
-maintain employment and income levels during a period of economic crisis.

"This initiative will also help set the stage for longer-term growth and development through programs to:

-realign regional trade patterns;
-identify and exploit production and resource complementarities to develop local industries and promote exports;
-embark on a new economic reform program;
-implement an equitable regional growth strategy to raise incomes and increase employment;
-restore the regional transport system to its former status -- one that is efficient, reliable, well-managed and maintained, and of service to the majority of producers and consumers of the region."[7]

The program articulated in this Initiative was to be three-pronged, consisting of approximately equal shares of resources devoted to: promotion of trade and investment, through provision of foreign exchange and support for regional financing mechanisms; support for private sector oriented policy reform by

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[6] U.S. Agency for International Development, An Initiative for Economic Progress in Southern Africa, p. 5.

[7] U.S. Agency for International Development, An Initiative for Economic Progress in Southern Africa, p. 6.

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member countries; and support for priority regional transport projects. As it focused on trade and industrial development, the strategy recognized that a "positive policy environment" within each country and among the countries of the region was of paramount importance. But adjustments were required in exchange rates, tariff schedules and other trade policies, monetary policy, capital market structures and investment policies. Therefore:

> "Our objective will be to promote economic growth through reforms that will lead to increased production, adoption of realistic exchange rates, improved tariff structures and increased earnings from trade and investment."[8]

The Initiative is vague concerning how policy reform would be carried out on a regional basis, recognizing that such reform must be done by individual countries and is "best supported through bilateral assistance."

Directly related to "trade and investment" the programs identified in the Initiative were: Market Data Systems, Export Pre-Financing Revolving Fund, and Export Credit Facility. This indirectly represents the Initiative's industrial strategy also, since:

> "The manufacturing sector (in the SADCC region) is heavily dependent on imported raw materials and intermediate and capital goods. Shortages of foreign exchange constrain those imports and make expansion difficult if not impossible. Additional mechanisms are needed to make foreign exchange available to potential exporters."[9]

<u>February, 1987: A.I.D. Southern Africa Regional Budget Request for Fiscal Year 1988</u>

The first regular A.I.D. budgeting request in the area of trade and investment came in SARP's FY 1988 Budget Request. There was an FY 1987 supplemental request related to the Southern Africa Initiative for Economic Progress (asking for $36 million, with $30 million for transport and $6 million for Market Data Systems under the Trade and Investment Sector). The FY 1988 request for Southern Africa Regional Programs was for a total of $73 million, with $12 million for transport, $2 million for agricultural training, and $57 million to integrate the Southern Africa Regional Initiative into the regular budget cycle. This

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[8] U.S. Agency for International Development, <u>An Initiative for Economic Progress in Southern Africa</u>, p. 13.

[9] U.S. Agency for International Development, <u>An Initiative for Economic Progress in Southern Africa</u>, p. 15.

The proposed project is fully consistent with A.I.D. policy and strategy. The project focus is on SADCC export expansion, which serves as a driving force for increased foreign exchange earnings, income and employment. The explicit orientation of the project is the development of export promotion strategies and programs, which require the adoption of market policies and signals which collectively create a more competitive economic environment. The project places private enterprise development as the central focal point of the initiative, providing policy climates and direct technical assistance to private entrepreneur exporters.

C. REGIONAL PERSPECTIVE

This project employs a regional approach to seek regional objectives. It is the first project of its kind in the Southern Africa region. These factors necessarily introduce a level of complexity and risks regarding project coherence, implementation and control. These same risks have been identified and experienced in other projects sponsored by other regional offices (RDO/C, RDO/SP, A.I.D./ASEAN, etc.). Lessons learned from those experiences are described later in this paper.

Bilateral Missions operate assistance programs in each of the target host countries. It is therefore legitimate to ask why the project's goal and purpose cannot be pursued more effectively by the bilateral USAIDs. Another valid concern is whether the proposed project duplicates, overlaps or contradicts bilateral Mission initiatives.

USAID has decided to address these issues directly in developing, fashioning and considering the proposed project. A collective determination was reached that an effective regional project is not only possible but also highly desirable in the SADCC context. However, the concept is viable only if the following set of conditions are met.

- The project must reflect conceptual clarity and functional coherence to avoid the possibility, either actual or perceived, of representing a "slush fund" for financing an unconnected series of activities.

- Given the introduction of geographic complexity, the project must minimize functional complexity by incorporating a narrow focus for each activity and employing a strict set of criteria for screening activities and establishing priorities.

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- While retaining a narrow focus, the project must nevertheless be sufficiently flexible to allow for varying national circumstances, Mission goals and programs, and emerging "windows of opportunity," all of which require tailored national initiatives.

- Project activities must be conducted under a tightly controlled and closely monitored structure of management and administration.

Based on these considerations, the Zimbabwe Mission first set out to identify and develop a project which incorporates the strengths of both bilateral and regional approaches, and has focus, coherence and control. This effort also builds upon the Mission's recognition of a more conducive attitude within SADCC towards private sector participation in policy discussions, investment, production and exports.

Second, it was decided that the project's tailored services should be "Mission driven," to the extent that initial activities should be identified by or in close coordination with USAIDs as well as SADCC. A large number of project ideas were collected by the design team, which visited each Mission in the region.

Third, the scope of the project was narrowed from five to two components (described below) and a set of selection criteria for screening prospective activities and setting priorities was developed. This process considerably reduced the range of potential activities.

Fourth, the design team crafted the project concept to incorporate two elements of a regional approach. The project will provide a common set of tailored services and assistance organized and managed under a regional framework, which offers efficiency and economies of scale, since many Missions do not possess the financial or administrative resources sufficient for comparable projects structured on an individaul basis. In addition, the project will work closely with regional organizations, specifically the official SADCC sector units and the SADCC Regional Business Council and its constituent national councils.

Fifth, after considering a number of alternative implementation plans, the Mission opted for an approach which provides strong central management and control. Project activities in each country will be developed in consultation with, and supervised by USAIDs, but will be implemented by a central management contractor.

In sum, the project approach seeks to introduce a new export initiative with a strong private sector orientation into the region on an efficient, cost effective basis. The project will offer complementary but additional support to export promotion activities in each country of the region, and will expand the capacity of regional institutions to carry out their mandate to increase regional earnings from trade.

IV. PROJECT DESCRIPTION

A. STATEMENT OF THE PROBLEM

The export sectors of SADCC countries are characterized by heavy commodity concentration, lack of geographic diversity, limited growth, and low levels of domestic value added. This basic problem has resulted in economic stagnation, excessive dependence and vulnerability, chronic shortages of foreign exchange, and depressed standards of living.

Primary products dominate SADCC's exports. Angola's economy is highly dependent on exports of crude oil, Botswana and Zambia on minerals, and Malawi and Tanzania on agricultural commodities. Lesotho, Swaziland and Zimbabwe sell both agricultural and mineral exports. Only Zimbabwe exports a significant volume of manufactured goods. In sum, traditional agricultural and mineral commodities account for more than three fourths of total SADCC exports. Within manufacturing, only textiles represent a major export, accounting for eight percent of the region's total.

In contrast, manufactured goods (including refined oil) make up some 95 percent of SADCC's aggregate imports. Three categories of imports -- machinery, transport equipment and fuel -- comprise one half of the region's imports of manufactures. Domestic industry in all SADCC countries except Zimbabwe is focused almost exclusively on meeting domestic demand behind protective barriers. Most manufacturing is limited to production of basic consumer goods, agricultural output processing, and assembly operations.

The development of industrial exports has been checked by traditional import substitution trade policies, overvalued exchange rates, and price distortions which artificially raise the price of inputs. In combination economic resource shortages (capital, skilled labor, reliable and reasonably priced utilities, transportation and communications infrastructure), such export policy impediments have effectively ruled out any prospect for initiating manufactured good exports.

Intra-SADCC trade is relatively small and has actually fallen in recent years. Intra-regional exports dropped from 7.0

percent of total SADCC exports in 1980 to 4.5 percent in 1986, and the share of intra-regional imports fell from 30 percent to 24 percent of the total over the same time period. By comparison, an average of 7.0 percent of SADCC exports and 30 percent of imports were traded with South Africa.

The nine SADCC countries operate within three different and overlapping regional trade regimes. These include the Southern African Customs Union (SACU) -- Lesotho and Swaziland being members along with South Africa; the Preferential Trade Area of Eastern and Southern Africa -- SADCC nations (excluding Mozambique and Botswana) plus other countries in East Africa; and SADCC itself. Trade between SADCC countries and the rest of the PTA members has been relatively small, and mainly between neighboring countries.

Trade outside the region has also declined during the 1980s, with SADCC exports falling some 25 percent, from $6.8 billion in 1980 to $5.1 billion in 1986. This fall in dollar-denominated export value is due in part to depreciation of SADCC currencies against the dollar, but also to declining commodity prices, periods of prolonged drought, and destruction and destabilization of regional transportation linkages.

SADCC governments have long recognized that commodity and geographic concentration in the composition of trade both contribute to dependencies on South Africa and on world commodity markets that increase economic vulnerability. As a result, the sharing of regional production through intra-SADCC trade has been a cherished goal of SADCC. Industrial development is viewed as a regional objective, since economies of scale are expected to be achieved in an enlarged market. In pursuit of this goal, SADCC's initial approach was to consolidate and rehabilitate infrastructure to meet a pre-requisite to regional trade and production. In concert with external donor support, SADCC has made considerable progress in establishing a foundation of transportation infrastructure.

Notwithstanding improvements in infrastructure and established momentum on macroeconomic policy reforms, the basic goal of expanding exports, both intra and extra-regional, has proven elusive. The entire region as well as individual SADCC countries face substantial constraints to private sector-led export development. These constraints, whose degree of importance varies widely throughout the region and among countries, include the following:

1. Difficulties in moving exports within the region and to outside markets due to physical transportation infrastructure limitations, barriers to foreign exchange conversion, and lack of consistency in customs documentation.

2. Low levels of economic development in the region, witnessed by low incomes, limited economic diversification and rudimentary infrastructure and economic services.

3. Inappropriate national laws, regulations and procedures which collectively form the "export policy environment."

4. Lack of access by exporters to information and advice on business conditions, foreign markets and trade regulations, joint venture opportunities and other factors related to trade and investment.

5. Limited opportunities for economies of scale.

6. Traditions favoring state domination over economic activities, and discretionary and non-transparent decisionmaking.

7. General lack of entrepreneurial heritage outside of traditional commodity sectors, which dominate production and marketing structures and management systems.

Given the breadth and depth of these problems, in addition to others such as inadequate access to financing and capital at reasonable terms, one could legitimately write off the prospects of market-oriented export development in the SADCC nations. However, previous experience of such countries as South Korea and the Republic of China (Taiwan), which faced even more serious constraints in the early phases of their recent development history, indicates that even the direst of circumstances can be overcome.

The majority of A.I.D. and other donor initiatives to remove constraints within the SADCC region have fallen into the categories of poverty reduction and transportation infrastructure development. Successes in these areas and basic shifts in host country attitudes indicate that the constraints listed above can now be effectively addressed. Meeting the need to overcome these constraints represents the focus of the proposed project.

B. PROJECT GOAL AND PURPOSE

The EES project goal is to increase SADCC member-countries' economic growth through expanded exports. Exports contribute directly to economic growth by creating employment and generating income and foreign exchange earnings, which can finance debt servicing obligations and imports required for both productive investment and consumption. Expanding export sectors also stimulate investment, increased production capacity and capital market formation, all of which enhance growth performance. In addition, the establishment of viable export sectors promotes sustained growth in that export competitiveness requires efficiency, and hence a policy environment that allows the efficient mobilization and bundling of economic resources without discretionary distortions. Thus a focus on exports fosters economic policies and strategies which serve sustained growth in domestic production and consumption as well.

The project purpose is to improve the policy and regulatory environment within which exports occur, and to increase exports from the private sector, through activities which are consistent with SADCC's evolving trade and industry strategy and Program of Action. The project seeks to assist private sectors and governments in the SADCC region to establish a policy and institutional environment which supports rather than deters long-term export development. In the absence of a "critical mass" of local exporters, which is the case in most SADCC countries, it would be difficult to persuade policymakers to make hard choices which bear real costs without tangible benefits. Therefore, the project will also provide direct assistance to exporters, who in turn will gradually form constituencies which promote further export-oriented initiatives and policy reforms. Simultaneously, the benefits generated by the growing export volumes will indicate the merits of previous and prospective reforms.

C. EXPECTED ACHIEVEMENTS AND ACCOMPLISHMENTS

The EES project is intended and designed to develop a solid foundation of regional attitudes, policies, and institutional support systems which promote long-term export growth. Project activities will not duplicate USAID Mission initiatives and will not place a heavy administrative burden on Missions. The End of Project Status (EOPS) will include the following accomplishments:

- The SADCC Sector Coordinating Unit for Trade and Industry will have enhanced capacity to formulate a Program of Action, analyze regional trade issues and communicate with the region's private sector exporters.

- Governments and private sectors in the region will be constructively engaged in dialogue on policies related to export expansion.

- SADCC Business Councils and national private sector organizations will have a strengthened capacity to conduct policy dialogue and provide services to their memberships.

- Government actions will have alleviated policy, regulatory and procedural constraints to export activity.

- Private sector exporters will have improved access to export-related information and services.

- Public sector organizations, both regional and national, will play a more effective supporting role for private sector organizations.

- Private sector exports will have increased quantitatively and as a proportion of regional exports.

These achievements individually represent important elements of a comprehensive export development strategy, as experienced in successful "newly industrializing countries (NICs)." Collectively, the project's accomplishments produce momentum for a series of changes and initiatives which foster not only export growth but also sound, long-term development progress.

D. PROJECT OUTLINE

The proposed Export Enterprise Support (EES) project includes two components: Policy Analysis, Dialogue and Implementation Assistance; and Export Promotion Information and Services. Three additional project components identified by Missions were evaluated and eliminated. On grounds of the need for project focus and clarity, the following components were eliminated from Phase I of the project: Financial assistance (loan guarantees, export finance, revolving credit fund, etc.); access to sites and services (factory shells/industrial parks); and policy reform program assistance. Each of these components has merit, since each addresses serious constraints to export development. However, in the interest of narrowing the project focus, the team concluded that these components should be eliminated from consideration under the first phase of the program, but considered for future phases or other projects within the RDSS strategy.

The policy and promotion components of the project will be pursued at both regional and national levels. Each component will in most cases include activities which assist both government entities and business organizations. The entire list of project activities identified and considered is shown in Annexes B (regional) and C (national). Annex D presents a summary of the activities chosen or rejected.

The project team developed a set of initial selection criteria for eligibility. Project activities to benefit from assistance under this project must:

1. Be consistent with SADCC strategy and supported by the host country government.

2. Contribute to export expansion in the private sector.

3. Possess the potential for application in a multi-country or regional context.

4. Be conducive to economies of scale in service delivery.

5. Have proven historical basis or reasonable conceptual basis for achieving desired results.

6. Not place excessive administrative burdens on USAID Missions.

In addition to meeting all of the criteria listed above, the activities must either:

7. Promote public and private sector dialogue within SADCC countries, or in SADCC as a region (including the SADCC Business Councils), or

8. Serve businesses by (a) providing technical services to private exporters at the firm level, or (b) strengthen business and public sector organizations servicing exporters at the national or regional level.

The process of evaluation and selection led the project team to include the following activities in EES project under the rubric of the two project components.

1. Policy Analysis and Implementation Assistance

The basic objective of this component is to enhance the capacity of SADCC governments and private sector organizations to engage in productive policy dialogue. This component includes long-term and short-term technical assistance, as well as institutional support to strengthen the policy dialogue capabilities of public and private sector organizations.

The substantive focus of the proposed project will encompass all areas of policies that affect export performance. However, an emphasis will be placed on directly relevant policies and procedures. These include tariffs and nontariff trade policies, customs procedures, tax laws and incentives, foreign exchange policies, business start-up regulations, labor laws and employee relations, and policies affecting access to export financing.

In addition to supporting analyses and dialogue on policy issues, the project will also provide assistance on alternative methods for implementing policy, regulation and procedure reforms identified. In many instances, government officials are aware of the merits of certain policy changes, but possess insufficient information on ways to implement those changes effectively and at minimum costs. This lack of knowledge can block reform even in cases where there is general consensus on the need for change. The project will provide experts with in-depth knowledge of various implementation techniques, as well as information on the experience of implementation successes and failures of other nations.

At the <u>regional level</u>, the policy subcomponents consist of the following activities, each of which is described in further detail in Annex D:

(a) <u>Institutional support to the SADCC Regional Business Council Secretariat</u>. The purpose of this activity is to help implement the new SADCC Business Council concept to enable the councils to promote effective policy dialogue and implementation.

(b) <u>Institutional support to the SADCC National Business Councils in member countries</u>. Grants to host institutions in each SADCC country will provide advice and equipment to enhance communication with members and the Regional Business Council Secretariat.

(c) <u>Analytical support to the Dar Trade and Industry Sector Coordinating Unit</u>. Technical assistance activity will assist the Unit to develop a Trade and Industry Program of Action for the new Trade and Industry Strategy, to revise and extend the Program of Action in subsequent years, and undertake export policy research in areas such as cross-border flows of goods and regulatory and procedural impediments to regional trade.

(d) Regional conferences of government export administration officials. Annual conferences would provide a forum for export officials to examine policy and promotion alternatives for expanding regional exports.

(e) Studies for EES Phase II development. Technical assistance funding would support studies and analyses of issues as important to regional exports and future project assistance.

The following policy dialogue activities will be implemented at the national level.

(f) Botswana: Export promotion policy dialogue and strategy development.

(g) Lesotho: Policy analysis.

(h) Malawi: Private sector issues identification and analysis.

(i) Mozambique: Support for AEPRIMO, private sector business association.

(j) Swaziland: Public/private policy dialogue and market forces encouragement.

(k) Swaziland: Investment and trade relations project with the Government of Swaziland.

(l) Tanzania: Policy analysis.

(m) Zimbabwe: Policy analysis.

2. Export Promotion Information and Services

The objective of this component is to provide assistance, both directly to firms and indirectly through business and government organizations, to current and prospective private sector exporters. The central focus will be information -- the knowledge and data that is required to initiate or expand export sales. This includes information on foreign markets, customs and other regulatory policies, distribution and marketing systems, potential joint venture partners, transportation alternatives, and other export-related factors. The component will include on training, technical assistance and technology transfer.

One part of this component is devoted to strengthening the capacity of government and business organizations to promote exports and assist exporters. This promotional component will include technical assistance and support in the following areas: development of strategic plans, preparation of organizational strategies, design and development of promotional materials, design of marketing campaigns, examination of information requirements and capacities, development of exporter servicing departments and establishment of monitoring systems. All successful exporting countries have in place organizations with strong capabilities for promotion and servicing assistance. With limited exceptions, the SADCC countries do not possess this capacity with a sufficient degree of effectiveness.

A second group of promotional activities falls into the category of technical assistance provided directly to exporters. Project personnel and regional and external experts will provide pertinent information and help private businesses develop export plans. Functional areas to be included are market assessments, export financing alternatives, quality control requirements, sources and methods for technology acquisition, and trade documentation.

To the extent possible, the project will emphasize methods for increasing U.S. trade and investment in the region, in line with U.S. development and economic policy. Efforts will be made to increase U.S.-SADCC two-way trade flows, and to introduce U.S. investors to the region. However, given current low levels of U.S. commercial relations and a realistic assessment of future prospects and opportunities, project activities will not preclude promotional activities involving other countries and regions.

At the regional level, the subcomponent activities under the export promotion information and services component consist of the following, each of which is described in further detail in Annex D.

(a) Regional conferences of business organizations. Annual conferences will be held to strengthen the capacity of business organizations to serve their memberships. Seminars, case studies and workshops will be presented on business organization models, development and membership services.

(b) Regional promotion and information activity, Harare-based. Regional advisory services will be responsible for promotion of the region's exports. The adviser will backstop USAID Missions, handle requests for assistance to individual exporters or export promotion organizations, and develop regional promotion activities.

(c) Rotating specialized seminars for exporters. This subcomponent will administer short-term seminars and workshops on various aspects of export activity. The courses would move sequentially throughout the region to provide access to information in a cost-effective way.

(d) Export management training courses. Continuing courses would address an identified need for managerial training for exporters. Weekend or evening seminars would rotate to several locations in the region on a monthly basis. Certificates would be awarded to those completing the course sequence.

(e) OPIC/business group missions to the region. Two missions per year sponsored by OPIC or other appropriate organizations will be held to introduce U.S. foreign investors to the region and develop potential joint-ventures or marketing arrangements.

The following export promotion information and service activities will be implemented at the national level:

(f) Botswana: Government of Botswana export promotion institution building.

(g) Botswana: Foreign joint and co-venture assistance.

(h) Botswana: Participation in regional trade initiatives.

(i) **Botswana: Product/market development for high-growth potential and labor intensive businesses.**

(j) Botswana: Key growth interventions to assist the private sector.

(k) Lesotho: Trade Promotion Unit support.

(l) Lesotho: Small Business Development Center in LCCI.

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(m) Lesotho: Loan portfolio guarantee assessment assistance in LCCI.

(n) Lesotho: Pre-feasibility studies for large businesses through LNDC and MT&I.

(o) Malawi: Export Promotion Council assistance.

(p) Mozambique: Assistance to GPIE, the Office for Foreign Investment Promotion.

(q) Mozambique: Assistance to National Directorate for Foreign Trade Operations.

(r) Mozambique: Export processing zone development feasibility/design assistance.

(s) Swaziland: Start-up and growth of export-oriented small enterprises assistance.

(t) Swaziland: Export business representation and business association assistance.

(u) Swaziland: Foreign joint and co-venture development.

(v) Tanzania: Assistance to export-oriented businesses.

(w) Zambia: Zambia Agribusiness and Management Support Project (ZAMS) third year supplement for technical services to exporters.

(x) Zambia: Extention of IESC services under ZAMS to include private export producers.

(y) Zimbabwe: Support for Zimbabwe Export Promotion Program (ZEPP) activities, integration into new quasi-private Zimbabwe International Trade Organization (ZITO).

All of the project subcomponents listed above meet the selection criteria established. In combination, they represent a unified but comprehensive set of activities that directly or indirectly assist exporters. In addition, they constitute a critical mass of regional activity which may lead to larger bilateral projects and programs. Finally, they serve as "incubators" for an experimental program which inaugurates a private sector-oriented export development initiative in the SADCC region.

E. INDICATIVE IMPLEMENTATION PLAN

In view of the complexities of a project of this kind, the the Mission undertook to examine the merits and efficacy of alternative implementation approaches. Though certain issues remain to be resolved, it is proposed that the implementation plan include the following characteristics.

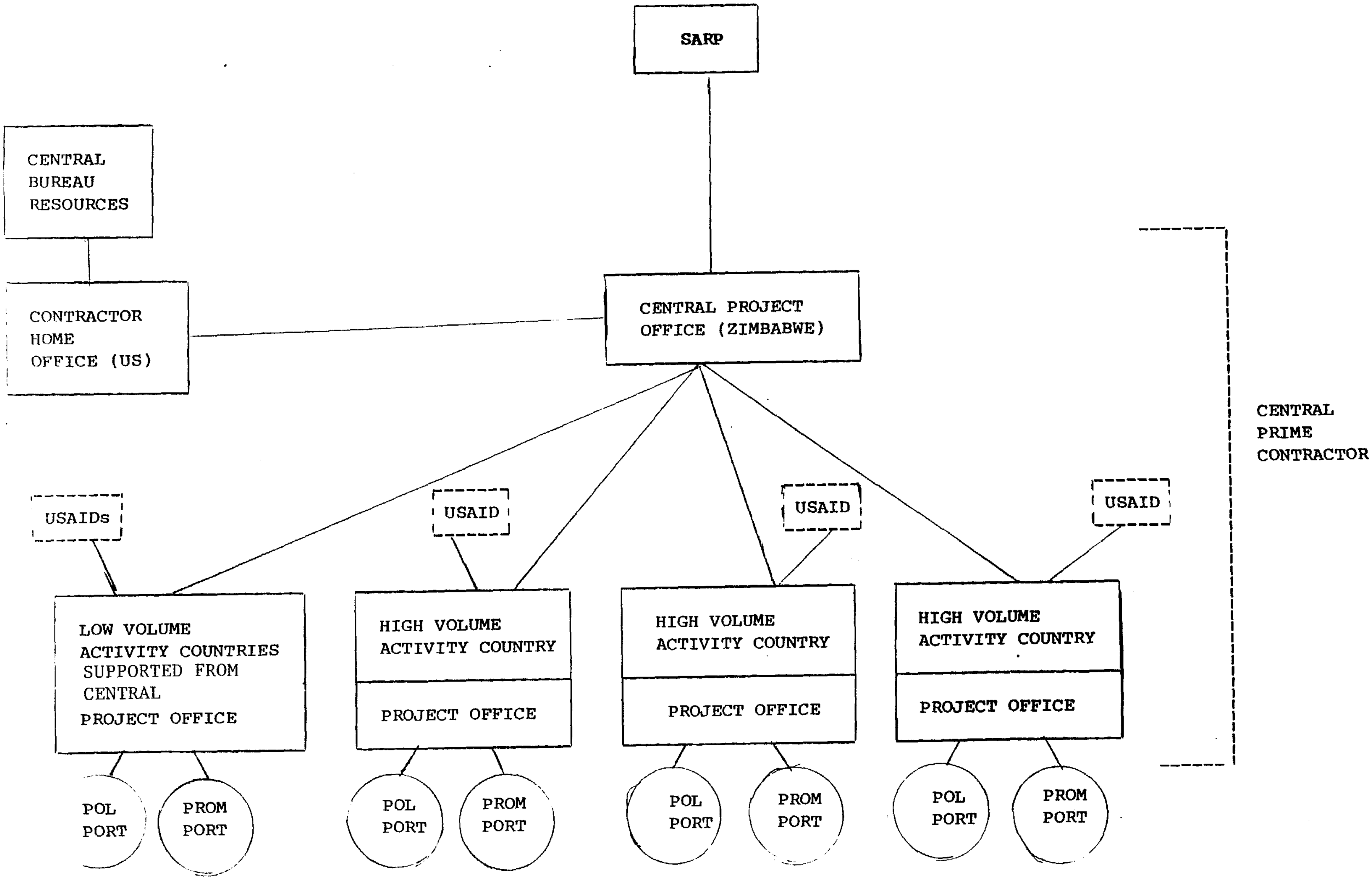
Fundamental to the structuring of the implementation plan is the recognition of regional needs which emanate from the evolving SADCC trade and industry strategy. The project plan provides for efficient delivery of services, taking advantage of economies of scale through regional implementation. In addition, the proposed structure promotes cross-fertilization of ideas and approaches throughout the region, and develops a cadre of professional expertise to deal with export problems and opportunities in Southern Africa. The implementation approach is designed to provide strong accountability, sound management, and cost effectiveness.

The services provided under the project will be administered according to the structure indicated in the attached organization chart. The Zimbabwe Mission will provide management oversight and monitoring, and will coordinate relationships between technical assistance beneficiaries and providers, as well as among SADCC, host country governments, and bilateral USAID programs.

Project service delivery and administration will be the responsibility of a central contractor. The contractor will establish a central project office in Harare. This office will manage all project activities, will coordinate the delivery of services and assistance to regional and national entities, and will service directly those countries in which there is insufficient activity to warrant a country project office. The contractor will also establish country project offices, outside USAID Missions, in those countries with a sufficiently large case load of project activities.

The country project offices (and the Harare project office assisting nations without a country project office) will be responsible for implementing portfolios of projects under the two project components -- policy and promotion/technical assistance. The country project offices will report administratively to the central project office (contractor), but programmatically to the bilateral USAID Mission. The primary function of the country project offices will be substantive (undertake policy dialogue assistance, exporter technical assistance, institution building assistance, etc.). In addition, the project offices will provide project-related administrative support to USAID Missions.

PROJECT ORGANIZATIONAL STRUCTURE



COUNTRY PROJECT OFFICES REPORT ADMINISTRATIVELY TO CENTRAL PROJECT OFFICE (CONTRACTOR), BUT PROGRAMMATICALLY TO LOCAL USAID MISSION.

NOTE: POL PORT = POLICY PORTFOLIO PROM PORT = PROMOTION PORTFOLIO

The project contractor will be responsible for providing both project administration and delivery of substantive technical assistance services. In view of the extent of issue areas covered and number of activities included, it would be highly desirable that the contractor be a consortium of firms (a prime contractor, subcontractors, and consultants) which have demonstrated capabilities in the following areas: Project management and administration; macroeconomic policy analysis; analysis of trade and investment policies, regulations and procedures; policy dialogue techniques; investment/trade promotion structures and methods; business organization development; private sector development strategies; trade marketing, finance and management; sectoral expertise in agribusiness and light manufacturing; and business skill training.

The project contractor will be responsible for developing detailed annual work plans in collaboration with SADCC, host country governments, and bilateral USAID Missions. The annual work plans will be reviewed, refined and approved by USAID/Zimbabwe. The work plans will be agreed upon by the SADCC Sector Unit.

Given the breadth of needs in the region, the project identification team has determined that it is also desirable for the project to supplement the central contractor resources, which may be limited in scope and/or depth, with a mechanism to access the technical resources available in several A.I.D. Central and Regional Bureau contracts. A list of relevant contracts is shown in Annex I. The principal candidates for project buy-ins include the following: The Private Enterprise Development Support (PEDS) project of PRE; the International Executive Service Corps grant of PRE; The Growth and Equity through Microenterprise Investments and Institutions (GEMINI) program of S&T; and the Consulting Assistance in the design and implementation of Economic Reform (CAER) program of PPC. In addition to these four central contracts, consideration could be given to access technical assistance resources from PPC's Macroeconomic Services IQC and REDSO's Africa-wide Private Sector Development IQC.

The AID/Washington resources would supplement those of the project contractor, and would offer USAIDs funding and contractual access to these resources through the project. If the contractor is unable to deliver high quality technical assistance services (quality of professionals, time availability, etc.), the Harare-based program funded project manager or USAIDs would request the contractor to work with SARP to access alternative services through buy-ins.

F. PROPOSED GRANTEES AND IMPLEMENTING AGENCIES

The proposal is to obligate the authorized funds through a written agreement with the Government of Tanzania in its capacity as the host country of the SADCC Sector Coordinating Unit for Trade and Industry, consistent with existing obligation procedures mutually agreed upon between USAID/Zimbabwe and SADCC. The Agreement and a side letter, as necessary, will establish that a large amount of the funds so obligated will be committed to a competitively bid direct AID contract with a central project contractor, who will provide administrative and technical services. The contractor will draw on expertise from the United States and from the region. Addition of funds to AID Central and Regional Bureau contracts is planned in order to provide access to additional technical assistance resources. Accordingly, the Agreement with the Government of Tanzania also will provide that part of the obligated funds will be jprogrammed for such buy-ins. USAID/Zimbabwe and the central contractor will collaborate in the development of annual work plans which will set forth the activities (including estimated budget requirements) to be undertaken by the central contractor and through buy-ins to central contracts. Any necessary Sector Unit approval for contemplated contracting, buy-in or other activities not covered in the agreement can be obtained through agreement on the annual workplan or Sector Unit written approval of PIO's, PIL's or Agreement amendments, as appropriate.

G. DESIGN ISSUES

Several project design issues emerged during the project identification analysis and consideration. Resolution of these issues, one of which is substantive and the rest of which relate to implementation, will be a central task during project development.

1. Project components. The substantive issue involves the number of components proposed for the project. According to one view, the project should include more than the two components proposed. Specifically, one would consist of a separate and more highly visible component to develop in-country business organizations to establish an "enabling environment" for policy dialogue and services to firms. Such a component is suggested by the results of MAPS exercises conducted in several SADCC countries. Additional components would be the provision of various trade finance facilities and the provision of sites and services. The project.team opted for only two components for purposes of project narrowing, with institution building subsumed under the policy and promotion components, and the finance

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component eliminated altogether. However, this issue should be addressed in further detail.

2. Country project offices. The identification team held differing views on the utility and necessity of country project offices in some SADCC countries. According to one perspective, the country offices would be costly, could raise concerns in bilateral Missions regarding control, and would be unnecessary, since the project activities could be administered by the Harare project office and by PSCs in each Mission. The opposing view holds that the project is "labor intensive" in that it is primarily technical assistance to a variety of beneficiaries, which requires an on-going substantive presence in each country with a large program of activities. The core of this issue is the degree of centralization versus decentralization that is required and/or desirable. The merits and practical implications of both structures will have to be carefully considered.

3. Level of detail of sub-component activities. A large number of candidates for project activities were identified during field research and evaluated for eligibility, in considerable detail. However, the project is experimental in nature and extends over a number of years. A question has been raised as to whether project subcomponents should be specified over the entire project period, or whether activities in out-lying years should be developed over time, subjected to selection criteria, and presented in detailed annual work plans. One side of the argument is that the project should be tightly defined at the Project Paper stage, with all sub-components specified subject to periodic review. The other view argues for flexibility after year one to introduce new activities created by changed circumstances and "windows of opportunity." This issue will have to be resolved.

4. Use of Central Bureau buy-ins. To what extent should the central contractor consortium provide all of the required technical assistance and other services, versus reliance on Central Bureau resources? On the one hand, incorporating a mechanism to buy into Central Bureau contracts offers access to a wide range of contractor organizations and resources, which might not be available in the consortium that is selected through a competitive bidding process. On the other hand, the buy-in option raises concerns over duplication of effort between the central contractor and buy-in firms, an additional layer of administration, since USAID/Zimbabwe would have to process documents for Washington action to arrange buy-ins. Issues related to the locus of ultimate responsibility for contribution to the regional project may also arise. The buy-in option remains in the initial project design, but its presence in the final implementation plan will have to be explored further.

V. FACTORS AFFECTING PROJECT SELECTION AND FURTHER DEVELOPMENT

A. SOCIAL CONSIDERATIONS

The socio-cultural context of this project is one of national boundaries cutting across a variety of ethnic and tribal affiliations. Nation-building is at an early stage, as black majority-ruled governments consolidate power, and seek long-term solutions to multi-racial participation in political and economic development.

The primary beneficiaries of the proposed project will be private individuals and businesses, seeking an environment in which risk and reward according to market forces are increasingly predominant. The benefits derived from private sector exports -- employment, income, foreign exchange and tax revenue -- will be distributed widely thoughout the SADCC economies. In addition, the focus on non-traditional export activity will encourage individuals and firms which have not participated in export activities in an environment dominated by parastatal corporations and heavy government controls.

As policy strategies shift from import substitution to export promotion, private sector producers in agribusiness and light manufacturing sectors will be encouraged. This results in additional production and employment in rural and secondary urban areas, thereby reducing urban subsidy and migration in the region.

B. ECONOMIC AND FINANCIAL CONSIDERATIONS

As described in the Problem Statement section, this project seeks to assist SADCC countries to shift policy strategies in such a way as to stimulate long-term, sustainable economic growth. This involves strategies focused on developing comparative advantages, reducing administered pricing, dismantling government controls and other impediments, and providing market signals and incentives for investment and production. All of these are consistent with accepted economic theory and proven performance in successful "newly industrializing countries."

The proposed project is designed to deliver project assistance in a cost-effective manner, building upon economies of scale through regional mechanisms. More costly project components and delivery systems were considered and rejected.

Within the SADCC environment, the proposed components and implementation plan have been developed on a least cost basis.

C. RELEVANT EXPERIENCE WITH SIMILAR PROJECTS

A.I.D. has undertaken numerous projects from which relevant lessons can be drawn to provide guidance for this initiative. These projects fall into two categories: similar regional activities, and similar projects (bilateral) that seek to stimulate exports and/or private enterprise ventures. A regional investment/export promotion project (PDAP) was implemented in the Eastern Caribbean by RDO/C, which has managed numerous other regional activities of this kind. A regional private enterprise development project was identified for RDO/SP in the South Pacific, and is in the process of being implemented. A.I.D./ASEAN has initiated a Private Investment and Trade Opportunities (PITO) project for the region. In addition, the AFR/MDI, LAC/PRE and ANE Bureaus have all sponsored private sector/investment/export initiatives on a regional basis.

Several important lessons emerged from these initiatives. First, the activities should be conceived and organized under a clearly defined, focused set of goals and strategies, lest the project become "all things to all people." This problem emerged in the RDO/C PDAP project. Second, the project concept and implementation plan should be sufficiently flexible to allow for varying circumstances and consequent tailored project application in different countries. Efforts to "force fit" rigid approaches throughout a region have led to unnecessary tensions in individual host country settings, as well as disappointing project performance. Third, regional initiatives should be administered under a strong, tightly managed structure with specifically defined roles and responsibilities. A regional project cannot "manage itself," but must be guided, controlled and monitored closely by both contractor management and sponsoring Missions. Fourth, contractors should be given clear instructions regarding their scopes of work, lest conflicting instructions lead to misconceptions on roles and performance. Scopes may change over time, but in any given time period should be specifically identified.

The experience of projects (bilateral or regional) focusing on trade/investment promotion and private enterprise yield several practical lessons and points of guidance. Projects of this kind are most effective when they engage both governments and private sector entities in the activity. Most of the long-term "deliverers" of services (promotion, assistance, etc.) to business are or should be government agencies, which often become "champions" of business within the government structure. In addition, it is the responsibility of governments to establish

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the business policy and regulatory system, and most often government policies are the principle constraint to private sector trade and investment. At the same time, private sector organizations can play active roles in not only policy dialogue and formulation, but also service delivery to private firms. Therefore, the policy/service capacity of both governments and business organizations should be enhanced.

A major lesson for policy dialogue initiatives revolves around the need for advisers to objectively identify, if possible quantify and present the costs and benefits of alternative approaches. Ideas for reforms should be presented in the long-term self interest of the host country, along with examples of successes and failures of strategies in other countries. In addition, policymakers should be given practical assistance on policy reform implementation strategies, since they often know the appropriate direction of policy change but have limited knowledge of phasing or cost-minimizing techniques. Finally, considerable attention to the development of constituencies in both the public and private sector to support identified policy initiative. Too little emphasis is given to support mechanisms.

A major lesson drawn from promotional activities is the critical need for promotional organizations to develop a strong institutional capacity for delivering information and services, and following-up on inquiries before active marketing initiatives are undertaken. Too often organizations rush to the glamor of marketing (trade missions, advertising, seminars, etc.) before they have follow-up capabilities, and hence trade and investment leads lie fallow and die. Another guiding principle is the importance of "transferring technology" from contractors to host country entities in the promotion area according to a predetermined training program. In addition, experience elsewhere indicates the desirability of approaching promotion, information dissemination and entrepreneur assistance as a collective effort for a wide series of public and private sector organizations. Finally, previous projects have shown that there is often a considerable difference between theory and performance in enterprise development initiatives. Many ideas are fine in theory (e.g., matchmaking services, self-financing promotion organizations, fees for services, etc.), but have not been successful in practice. Therefore, considerable care must be given both to project ideas and to promises made by grantees and contractors.

D. WOMEN IN DEVELOPMENT

In many of the SADCC countries, women are responsible for much of the effort for producing both subsistence and cash crops in rural areas. The pattern of urban migration has been predominantly male, leading to disproportionate male participation in urban labor forces and in management. Experience has shown that the reduction of urban bias and government domination over economic decisions, which are key objectives of this project, have improved the participation, upward mobility and status of women.

A large share of entrepreneurs in the informal sector are women, who for various social and economic reasons have difficulties in joining the formal sector. This project seeks to reduce constraints on export-oriented entrepreneurs, and hence has the ancillary effect of empowering women to participate more fully in income generating activities.

E. ELIGIBILITY OF CONTRACT FIRMS

USAID/Zimbabwe anticipates that contract activity funded under this project will be suitable for participation by firms located with the region and U.S. firms which are minority or women-owned and operated.

F. ILLUSTRATIVE BUDGET

For further details, see supporting Annexes C and D.

	US$Million
Policy Analysis, Dialogue and Implementation Assistance	
Regional sub-components	2.5
National sub-components	6.7
Export Promotion Information and Services	
Regional sub-components	2.4
National sub-components	13.5
Project Management and Implementation Support*	5.0
Total	30.1

* Assumes central project office, three country offices, plus contractor home office support and overheads.

Export Enterprise Support (EES) Project

Supplementary Annexes

A. Preliminary Logical Framework

B. Background Information on SADCC Regional Project Activities

C. Background Information on SADCC Country Project Activities

Botswana
Lesotho
Malawi
Mozambique
Swaziland
Tanzania
Zambia
Zimbabwe

D. Selection of Project Components

E. U.S. AID Policy Towards Trade and Entrepreneurship

F. U.S. AID Trade and Entrepreneurship Policy for Southern Africa

G. SADCC Policy Towards Trade, Industrial Development and Entrepreneurship

H. Relation of Trade and Industrialization to Economic Growth and Development: Perspectives from Economic Theory

I. Description of Central and Regional Projects

J. Economic Policy Profiles for SADCC Countries

Botswana
Lesotho
Malawi
Mozambique
Swaziland
Tanzania
Zambia
Zimbabwe

K. FY 1989 Congressional Appropriation for Southern Africa, Development Assistance

PRELIMINARY LOGICAL FRAMEWORK
REGIONAL TRADE AND ENTREPRENEURSHIP PROMOTION PROJECT
(690-0245)

NARRATIVE SUMMARY	OBJECTIVE VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
PROJECT GOAL:	**MEASURES OF GOAL ACHIEVEMENT:**		
To increase SADCC member-countries' economic growth through expanded exports.	1. Increased foreign exchange earnings. 2. Increased employment in export-related industry.	Government and Chamber of Commerce statistics.	1. Overseas markets remain open to SADCC member-country exports. 2. World macro-economic conditions remain viable. 3. Transportation linkages to export markets remain viable.
PROJECT PURPOSE:	**END OF PROJECT STATUS (EOPS):**		
To improve the policy and regulatory environment within which exports occur and to increase exports from the private sector.	1. Enhanced dialogue among private sector exporters in the SADCC region under the auspices of a strengthened SADCC regional Business Council. 2. Enhanced dialogue between governments and the private sector. 3. Strengthened SADCC national business councils and other private sector business organizations. 4. Government actions alleviate procedural, regulatory or policy constraints to export activity. 5. Private sector exports have improved access to export-related information and services.	1. Frequency of formal contacts among private sector exporters within the SADCC region as a whole. 2. Frequency of formal contacts between private and public sector representatives on export-promotion issues. 3. A qualitative assessment of the capacities of regional and national business organizations to engage in effective policy dialogue and deliver export-related services to their members. 4. Identifiable government initiatives to enact procedural, regulatory of policy reforms.	1. Government amenable to procedural, regulatory or policy reforms to facilitate private-sector export activities. 2. No major collapse of commodity markets affecting exports from the SADCC region.

NARRATIVE SUMMARY	OBJECTIVE VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
	<u>END OF PROJECT STATUS (EOPS)</u>(cont.):		
	6. Public sector organizations, both regional and national, play a more effective supporting role for private sector exporters.	5. Evaluation of project initiatives to improve or augment the delivery of export-related information and services to private sector exporters.	
	7. Private sector exports increase quantitatively and as a proportion of regional exports.	6. A qualitative assessment of public sector export-promotion entities benefiting from project interventions.	
	8. A SADCC Sector Coordinating Unit for Trade and Industry better prepared to implement a revised Program of Action.	7. Government and Chamber of Commerce statistics.	
<u>PROJECT OUTPUTS</u>:	<u>MAGNITUDE OF OUTPUTS</u>:		
1. Procedural, regulatory or policy analyses provided to public and private sector entities. 2. Training, information and liaison services provided to exporters through private sector business organizations. 3. Seminars, workshops and periodic fora established for private and public sector representatives to meet to discuss export policy-related issues. 4. Seminars, workshops and periodic fora established for private sector exporters to meet among themselves within the SADCC region. 5. Improved public sector support services.		Project records, project manager oversight, periodic project-funded evaluations, Controllers' records.	Project activities intended to improve the skills and capacities of private sector firms and organizations are effectively targeted and implemented.

NARRATIVE SUMMARY	OBJECTIVE VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
PROJECT OUTPUTS (cont..)			
6. Private sector exporters trained and introduced to efficient production and marketing practices.			
7. Specific investment and market development opportunities identified and exploited.			
8. Technical assistance to private sector exporters improves export performance at the firm level.			
PROJECT INPUTS:			
1. Long and short term TA to assist in Policy Analysis, dialogue and reform implementation.			Project resources are sufficient and appropriate to achieve projected outputs.
2. Institutional development assistance to regional and national business organizations.			
3. Technical assistance to private sector exporters.			
4. Technical assistance to public sector export promotion units.			

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Export Enterprise Support (EES) Project

Annex B:

Background Information on
SADCC Regional Project Activities

There are a number of possibilities for truly regional activities to complement those identified by individual Missions in the SADCC countries. Visits with the SADCC Secretariat and the Dar Sector Unit contribute to the idea that such a regional set of activities is feasible and supportive of both the SADCC approach to trade and industry (as it is evolving) and AID's approach to providing assistance to private sector exporters in the region. Some initial discussions with Tony Hawkins, one of the major authors of the Draft Industry Strategy, contribute to the selection of areas for possible support.

This paper attempts to rough out some areas of possible support for a regional dimension to the proposed project. A few selected types of activities are suggested for possible AID support. They would appear to be consistent with both the SADCC evolving strategy and with the objectives of the AID Export Support Project being designed. Thus, the draft Industrial Strategy makes the following general observation about export activity in the region:

> "Export promotion programmes need to be targeted and focused. A significant degree of specialisation will be needed for SADCC exporters to penetrate highly competitive world markets. Past experience shows that efforts by small countries to develop a broad product range of industrial exports or to penetrate a large number of foreign markets are unlikely to succeed. Instead, SADCC states should adopt 'niche' strategies establishing narrowly-focused market niches in international markets. This has important implications for SADCC's regional industrial strategy since it means that individual member states too should specialise in developing products and industries in which they can achieve international competitive advantage."

The activities proposed below for AID support are all consistent and supportive of this SADCC export objective; they seek out particular problem areas which could effectively be addressed by AID.

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Selected Areas of Support

A key to the types of regional activities suggested here is initial institutional support to the SADCC Regional Business Council Secretariat to be located in Gabarone. It would be desirable also to find a mechanism to provide some institutional support to the various National Business Councils and/or representative business organizations. This is completely consistent with the explicit agenda of SADCC. Thus, the draft Industrial Strategy calls for:

> "...establishment and encouragement of regional Business Councils to provide a mechanism through which investment and trade opportunities can be publicised and which would provide a forum for the exchange of ideas between the public and enterprise sectors."

Such initial institutional strengthening of the Business Council concept also is necessary to provide some elements of the proposed project with an effective point of contact with the productive sector in the SADCC region. It does not assume that the various business councils will soon become uniformly strong. It does assume that they are a legitimate and, over time, effective ways to interact with the private sector. Further, it directly supports and assists the Councils to carry out key activities identified by SADCC in the document: "Roles and Functions of the SADCC Business Councils;" thus, the Councils will be expected to:

> "...facilitate the promotion of investment within the region through the identification of investment opportunities and requirements; and the fuller participation of local enterprises in national and regional projects.
>
> "...provide a forum for the exchange of information leading to the promotion of intra-regional trade.
>
> "...provide a forum for the exchange of views, ideas, and experience leading to the mobilisation of the enterprise community for the fulfillment of the region's development objectives, and the enhancement of regional cooperation generally."

Support to the Regional Business Council Secretariat, which presumably will physically be located in the SADCC Secretariat, should be generous! The SADCC Secretariat is stretched very thin and needs additional capacity; it is especially important that as the Business Council idea starts up there are ample resources to help the concept evolve as quickly as its membership and objectives allow. It is likewise important that the Regional Business Council Secretariat be capable of taking on liaison duties with some regional activities below which are recommended as being linked to the Business Council structure.

One regional activity recommended is a series of OPIC type missions to portions of the region (several countries at least). This would focus investor attention on the region and its broader markets and potential. This is consistent with the draft Industrial Strategy:

> "In the short-term the region's shortage of capital, technology and skills can be ameliorated by encouraging joint ventures both among the region's business community and with business men from outside the region."

But it would also leave those participating in the investment missions to decide which individual countries had promise and follow-up potential. Adequate pre- and post-mission preparations and follow-up support would be essential. The Regional Business Council (through its Secretariat) and the National Business Councils should be an integral part of preparing for such missions, hosting visitors, and designing follow-up activities. A service delivery mechanism needs to be identified to provide support to such a project activity. While it is realistic to include representatives of the Business Councils in the planning of such investor missions, and to have their members be part of the itinerary of activities, it is not realistic to push off on the Business Councils the actual administrative work. A contract with a qualified organization is necessary, linked to the Regional Business Council Secretariat with provision for dialogue and direction from the representatives of the business sector in the region.

An identified weakness to the current situation is weak promotional information on the region for potential investors and trade opportunities. Currently many visiting the region (and its individual countries) depend heavily on the Economist Intelligence Unit, whose data is usually 9 months out of date at least (and sometimes can draw only on data sources which themselves are many months behind reflecting recent trends). It has been suggested that a useful activity for the region would be maintenance of a current data base of information for investors, traders and others. This is consistent with the draft Industrial

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Strategy which states:

> "Increased investment by both foreign and domestic enterprises will be achieved by ensuring an enhanced flow of accurate market and investment information. ..."

It has further been suggested that the SADCC Regional Business Council, through its Secretariat, could be a viable location for such an activity (with suitable technical assistance). A network of contacts in member countries, possibly with someone at the universities or other appropriate organizations in each country, could be organized to provide information on a timely basis. This would deliver a badly needed service in association with the Business Council structure. It would also be a key ingredient to the OPIC type missions described above. Finally, it is consistent with SADCC objectives of investment and export promotion and use of the Business Council mechanism.

A third activity could be a series of sector seminars on a regional basis. This builds upon the idea that producers of a common product face a series of problems which are more similar than different throughout the region. By bringing together producers of a product like pharmaceuticals, it would be possible to start a sharing of views, develop a network, and provide assistance. If organized well, the seminar could include participation by leading producers around the world in the sector, as well as selected experts to discuss particular problems, trends and solutions. There would be need for careful pre- and post-seminar work. It might be that after the initial seminar some expert technical assistance could rotate through the region to assist individual producers in succession. Opportunities for regional sourcing of inputs, a sharing of technical expertise, and enhanced regional movement of products could result. In any case, it is a mechanism to bypass the government entities and bring assistance directly to selected productive sectors in the region. It is consistent with the draft Industrial Strategy which calls for:

> "Investment workshops/conferences for all industries which could be open ended, for specific groups of industries and/or for individual member states."

Some suggestions for sectors which could benefit from such seminars derive from the draft Industrial Strategy's list of "industry branches that offer the best opportunities for integrated and self-sustained industrial development":

Agro Industries
Food Processing
Forest-based Industries

Textiles/Clothing and Leather and Footwear Industries
Non-Metallic based Industries
Metallurgical Industries
Chemical Industries
Engineering Industries

It might be feasible again to use the Business Council construct as a mechanism for contacting producers in the region, identifying priorities for sectors as the focus for seminars, and as a co-sponsor for the seminars. This would demonstrate another type of service which Business Councils can bring to the countries, thus furthering their legitimacy and usefulness. Such an activity would require a service delivery arrangement that could draw upon world expertise to staff the seminars and provide follow-up activities. It should include a regional entity such as Imani Associates which has regional credibility and knowledge.

Another area of regional activity, perhaps further removed from what can be accomplished in a first phase, would be entrepreneurial and technical training on a regional basis. This derives from the observation that there is a severe shortage of trained individuals within business organizations and a scarcity of institutions or organizations capable of providing such training. The draft Industrial Strategy recognizes this problem:

> "Manufacturing activity in SADCC is characterised by heavy dependence on expatriate skills, especially in technical, financial and managerial disciplines. Increased and better-targeted investment in the development of the region's human resources is an essential pre-requisite for sustained industrial growth."

The irony is that often the business entities would be willing to share the cost of such training but it is not available. If organized on a regional basis, it might be feasible to have training short-courses rotate around the region on selected topics (like aspects of marketing, production control, financial management, etc.). National Business Councils and/or business organizations in the countries could be the co-sponsors of such training, thus drawing upon their contacts to solicit participants and providing additional services to members. Again, a service delivery mechanism would be needed that could work with organizations in the region to identify priority areas of short-course training, organize and coordinate teams to deliver the training, and otherwise make the training function on a regional basis.

These are a very small segment of the SADCC draft industry (and trade) strategy. But there is a common focus on targeting assistance to the productive sector directly while genuinely including business organizations (especially the Business Councils) in the planning and delivery but not overwhelming them with direct responsibility for service delivery. It is ambitious, but consistent with SADCC's priorities and AID's objectives to assist in Export Support.

The proposed project should also provide selected assistance to the Dar Sector Unit, while not depending upon it to deliver the types of services described above. The evolving industry strategy, once approved by the Council of Ministers, must be converted into a Program of Action. This is a very important step, and one for which the Dar unit is ill-equipped. AID could make a very important contribution by assisting in this process; at the same time, AID could help direct the program of action to most effectively use the private sector to accomplish the strategy and otherwise introduce constructive (and non-statist) approaches. This would supplement existing AID support to the SADCC Secretariat to undertake studies (some of which have helped move SADCC to the point of having a draft industry strategy for consideration).

It is proposed that the Export Support Project itself, as distinguished from AID support to the SADCC Secretariat and the Dar Sector Unit, also be capable of initiating selected studies and analysis on regional export issues to enrich the dialogue and options. Likewise the project should maintain an inventory of information on regional export issues and initiatives as well as donor support.

APPENDIX C

EXPORT ENTERPRISE SUPPORT (EES) PROJECT:
BACKGROUND INFORMATION ON SADCC COUNTRY PROJECT ACTIVITIES

BACKGROUND INFORMATION ON BOTSWANA

A. Background

USAID/Botswana's interest in the private sector and entrepreneurship, and especially exports, is relatively recent. Focus on such issues emerged about two years ago. The September 1983 Country Development Strategy Statement contains relatively little that deals explicitly with exports or with any emphasis on private sector promotion. Rather, the focus has been on employment generation per se and on manpower and training in particular. This orientation is reflected in the content of the three principal objectives of USAID/Botswana in 1983-85: "(1) To improve the quality and efficiency of the primary and post-primary educational systems to better meet projected workfoce requirements; (2) To provide advanced training for administrators and technical personnel to help increase and diversify employment opportunities; and (3) To strengthen selected institutions which are directly responsible for increasing agricultural and off-farm productivity and incomes in rural areas."

USAID's 1987 Strategy Assessment and Evaluation illustrates the evolution in the Mission's and the government's thinking about the most effective strategy for economic development. This document gives greater attention to the private sector and entrepreneurship. It addresses the various constraints which exist both in the informal and formal sector, for the private sector and entrepreneurship to be able to contribute more to the country's economic growth. The report dicusses the role of international trade in Botswana's development, both in terms of regional and overseas markets, and identifies difficulties to penetrate these markets successfully.

USAID's Private Sector Strategy Study is a detailed evaluation of various actions that the Mission can take to strengthen the private sector, including entrepreneurship and export oriented activities. While the issues of opportunities and constraints to exporting are not addressed in great detail in the report, actions recommended for strengthening the private sector would have positive implications for the country's export base.

B. Current status

Current thinking in the public and private sectors on strategies for private sector development in Botswana is found in the proceedings of the National Conference on Strategies for Private Sector Development. The conference was funded by UNDP and co-sponsored by the UNDP and the Government of Botswana, through its National Employment, Manpower and Incomes Council (NEMIC). Two of the four background papers prepared before the conference were on constraints facing private sector development and on foreign investment. This indicates a growing recognition that a strong private sector is necessary to solve key problems facing the economy of Botswana.

Foreign investment, which can only be viable for exporting to regional and/or overseas markets, is addressed at length. Issues considered include how to remove constraints and provide necessary incentives for foreign investors to come to Botswana. A number of specific recommendations were made by the conference on promotion and publicity, including: (1) a one-stop agency (for necessary permits); (2) strengthening the Trade and Investment Promotion Agency; (3) better training of commercial attaches; and (4) better promotion of foreign investment.

C. Future Plans

When the Minister of Finance and Development Planning, Mr. Mmusi, gave the keynote address to the conference on the private sector in Francistown in 1988, one of his major points was to stress that ". . .the time has come to move beyond the discussion stage to the action stage." Many of the recommendations of the conference, therefore, are indicative of plans of action at both the government and private sector level.

Additional information on what the government hopes to accomplish is found in the two budget speeches of 1988 and 1989. Among its goals was continued liberalization of credit to the private sector. The government also promises to make the processing of work permits easier, a step especially important to companies that need expatriate personnel, often required at least initially in exporting activities.

In his 1989 budget message, Mr. Mmusi gave greater attention to the private sector and trade. He reported that the government would investigate a new initiative for the clothing sector in Botswana, in direct response to requests from the private sector, recognizing " . . .the potential for export expansion in the textile industry, and will assist in enabling local firms to take advantage of world market opportunities". He continued ". . . Such dialogue with the private sector on potential initiatives is most encouraging, and I am hopeful that the private sector will continue to suggest areas where government can serve as a catalyst to development."

Finally, USAID's draft report on Manual for Action in the Private Sector gives some indication as to what efforts the Mission hopes to pursue in the support of private sector entrepreneurship and export activities. Specific potential actions relevant to entrepeneurship and exports falling out of the MAPS exercise are shown in the following section.

D. Indicative Requirements for Assistance

Indicative Requirement #1: Export Promotion Policy Dialogue and Strategy Development

A. Continuing

- Market Force Constraints
- Growth in High Export Potential Segments
- Coordination/Cooperation with Other Donors
- Discussion with Businesses

B. General Study

- Exposure of Key Decision Makers to Other Environments

Budget:

a. Short Term T.A. @ $14,000/mo.		None	
b. Long Term T.A. @ 125,000/yr.		None	
c. Other	Fund: 75% x $500		$ 375,000
	Training: $ 21/wk x 3 courses/yr		$ 189,000
TOTAL			$ 564,000

Indicative Requirement #3: GOB Export Promotion Institution Building

- Management of TIPA

- Regulations Review Board

- Support to BDC

- High Export Potential Industries

- OPEX Help in Portfolio Building

- S-T Foreign Expert Assistance

NOTES: This assistance includes two "OPEXers" (Operational experts) to TIPA and BDC (One position is already at TIPA but expires in 1990 and should continue. Assistance also provides for a "foreign deal maker". The government cannot now act proactively, a serious defect that this assistance would ameliorate.

Budget:

a. Short Term T.A. @ $14,000/mo.	5 person mos.	$ 70,000
b. Long Term T.A. @ $125,000/yr.	6 person yrs.	$750,000
c. Other		
TOTAL		$820,000

Indicative Requirement #4: Fo[illegible] Joint and Co-Ventures Support

- Study of Existing Assistance Elements

- Tie-ins to Non-USAID/B Projects

  - U.S. Overseas Private Investment Corporation (OPIC)

- Local Promotion Company Assistance

  - Cooperative Agreements

- Entrepreneur Exposure Trips to U.S.

  - "Entrepreneur International"

- Feasibility studies and business plans

NOTE: This section covers a variety of activities, including:

- study of systems, people, and organizations in Botswana for promoting joint ventures and co-ventures

- pre-project planning, post-project follow-up and monitoring. This would represent major improvement over current situation where investment missions are not as productive as they could be. Includes investment missions in general, not just OPIC missions.

- Up front payments or commissions that pays for part of the costs involved. "Trigger mechanism" would be involved which could result in payments at the letter-of-intent stage and another at the contract stage.

- Using Entrepreneur International is very cost effective for Mission as it only has to cover half of the per diem cost.

- Feasibility studies and business plans would go beyond APDF; for example, could help finance testing samples of products (hi es, for instance), and at least half a dozen deals in the country that could benefit from such assistance. BDC or local broker could help facilitate such private deals. One example provided was that of encouraging Heinz to use locally produced oil seeds by providing "commercialization grants" which would do feasibility study which would prove to Heinz that such a project would be profitable. Entrepreneur International could do some of this.

Budget:

a. Short Term T.A. @ $14,000/mo. 2 person mos.	$28,000
b. Long Term T.A. @ $125,000/yr. None	
c. Other:	
- Plan & FU for 2 OPIC missions @ $100:	$200,000
- OPIC miss. partic. cost support @ $100	$200,000
- Co-op agree. w/promo. co.	$ 50,000
ntrepreneur trips 20/yr. x $ 8	$480,000
- easibility studies $ 300/yr.	$900,000
TOTAL	$1858,000

Indicative Requirement #5: Participation in Regional Trade Initiatives

- SADCC
  - Banking
  - Joint Ventures
  - Trade and Trade Financing
- Lome
- Africa Project Development Facility
- Africa Management Services Company (new IFC unit)

NOTE: This component consists of travel funds necessary to cover many of the activities which need to be supported to stimulate increased exports. These include export opportunities coming out of SADCC programs, Lome (the EEC's trade preference for the Asia, Carribbean and Africa developing countries).

Budget:

a. Short Term T.A. @ $ 14,000/mo. None

b. Long Term T.A. @ $ 125,000/yr. None

c. Other:

- Travel costs $50/yr.	$150,000
TOTAL	$150,000

Indicative Requirement #6: Product/Market Development for High-Growth Potential and Labor Intensive Businesses

A. High Potential Exporters & Labor Intensive Businesses

- Identification of Potential Export Goods
- Provision of Industrial Premises
- Development of Specialized Agriculture
- Handicrafts and Export Marketing
- Strengthening of Business Brokers and Other Professional Services

B. Skills Training and Education

- Entrepreneurs
- Feasibility Studies
- Business Advisory Services
- Job Costing
- Tailored Courses
  - IDM (Institute for Development Management)
  - Brigades (Vocational Education)
  - IFS (Integrated Field Service)
  - BOCCIM (Botswana Confederation of Commerce, Industry and Manpower)

NOTE: Part A of this component is short term technical assistance for very specific product development; not company specific but focused on the whole sector. Part B is long term technical assistance, including dealing with product development and other problems impeding exports. Such activities could help leverage services provided now by Peace Corps volunteers, for example, who do not have the skills to provide such services.

Budget:

a. Short Term T.A. @ $14,000/mo.	A: 5 person mos./yr.	$210,000
b. Long Term T.A. @ $125,000/yr.	B: course developer	$375,000
c. Other: None		
TOTAL		$585,000

Indicative Requirement #7: Key Growth Interventions to assist the private sector

- Market Analyses
  - MSE & LSE Promotion for Local and Export Markets
- Market Knowledge
  - TIPA, GOB or BOCCIM Market Information
- IESC
  - Assistance to Local Businesses
  - Trade and Investment Services
- Export Marketing Procedure Information
- Quality/Competitiveness of Export Goods
- Finance
  - L-T Capital and Equity Supply
  - Working Capital Supply
  - Conservatism in Lending
  - Delays in Application Processing
  - Merchant Banking Facility
    - Large-Scale Trading
    - Industrial Enterprises
  - Capital Market Development
- FAP (Financial Assistance Program) Incentives
  - 5-year limit
  - Labor grants

- Tax Holiday Structure

- Fixed Capital Reimbursement Percentage

- Foreign Investment Promotion Component

- Bonded Warehousing

- Free Trade Zones ("Dry Ports")

NOTE: This component deals with constraints or areas that need studies and driven by the PSE, for example. These are different from policy studies as they are very short term interventions and project would cover only small part of an overall project, for example, by bringing in a worldclass expert in a given narrow area, like bonded warehouses or similar field. The list is only indicative for the type of specific studies that would be undertaken. Currently the Mission does not have the funds of the funding flexibility to finance such interventions.

Budget:

A. Short Term T/A @ $14,000/mo. 19 person mos.		$ 266,000
B. Long term T/A @ $125,000/yr.	None	
C. Other:	IESC $10/job x 1 job/mo.	$ 360,000
	Trade and Inv. Serv. $150/yr.	$ 450,000
Total		$1076,000

Indicative Requirement #8: Export Promotion Advisor

NOTE: This would involve putting a PSC in Mission to act as "agent" of central contractor in Harare but at same time responsive and responsible to Mission.

Budget:

A. Short term T/A @ $14,000/mo.	None	
B. Long term T/A @ $125,[illegible]r.	Pers. serv. contractor	$375,000
C. Other: None		
Total		$375,000

GRANT TOTAL

A. Short term T/A	$952,000
B. Long Term T/A	$1500,000
C. Other	$3399,000
Total	$5851,000

E. Other Donor Activities

USAID/B has "institutionalized" a dialog with other donors through its informal Private Sector Donor Group, which was organized about two years ago. Progress has been made on private sector regulatory and dialogue issues which the UNDP-sponored National Conference on Strategies for Private Sector

Development addressed in July, 1988. The package of recommended policy changes and permanent consultation mechanisms is currently before the Cabinet. The government has already adopted some recommendations, such as a package reducing residence and work permit difficulties which foreign investors or employees face.

Trade and entrepreneurship related issues addressed by donors in Botswana and projects supported by donors include the following:

- Improving work permit decision processes -- UNDP is providiing an expert to the Labor Department for this purpose.

- Commercial Attache Training -- UNDP/International Trade Center (ITC) is sponsoring a course, which will also include Trade Information and Promotion Agency (TIPA) people.

- Trade Expansion and Diversification -- UNDP and Denmark are providing a four-year assistance package to TIPA. It includes a librarian, an SEE advisor, a software expert to tie into UNCTAD's trade information network, a team leader (Dutch supported), and local counterparts for each foreign expert. The EEC is financing trade journals, etc., for TIPA.

- Africa Management Service Company -- UNDP is supporting more local activities of this regional International Finance Company (IFC) agency, which assists larger new or troubled companies to improve their managements and make their operations more efficient.

- Chamber of Commerce Visits -- The UK is sponsoring visits from various British cities.

- Technical Assistance to Small Scale Enterprise (SSE) lenders -- Germany is providing technical assistance and training to Tswelelo and Botswana Savings Bank.

- German-Botswana textile joint venture -- DEG (Finance Company for Investments in Developing Countries of the Federal Republic of Germany) is supporting this project, which will employ 200 people.

- Support to Norwegian firms for joint-ventures -- Norway is supporing such feasibility studies and investment misssions. In process are projects for cement, foundry, dairy and bricks.

- Lines of credit for Business Lending -- The EEC provides a line of credit to NDB for small scale enterprise lending through Tswelelo, and the European Development Bank provides a line through BDC for lending to seven larger local enterprises.

F Reference Documents

1. USAID Country Development Strategy Statement: Botswana; FY 1985; September 1983

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3. Private Sector Strategy Study; USAID/Botswana; September 1987

4. National Conference on strategies for private sector development; July 1988; UNDP

5. USAID Annual Budget Submission/FY1990/Botswana; June 1988

6. Budget Speech; by Mr. Mmusi, VP and Minister of Finance and Development Planning; 22 February, 1988

7. Budget Speech; by Mr. Mmusi, VP and Minister of Finance and Development Planning; 15 February, 1989

8. Manual for action in the private sector (MAPS); Draft report for USAID/Botswana; February 1989

BACKGROUND INFORMATION ON LESOTHO

A. Background

USAID/Lesotho's CDSS identifies the educational, agricultural and health sectors and the promotion of economic policy reform to support private sector initiatives as the priority areas for its development assistance to Lesotho. The Mission's project portfolio concentrates on the agricultural and educational sectors. The following constraints to Lesotho's social and economic development are emphasized in the Mission's CDSS as stated in Country Training Strategy--Human Resource Development Assistance Project:

- Lack of planning and decision making skills at middle and top management levels of key Government of Lesotho (GOL) ministries;

- Inefficient land-use and agricultural practices, resulting in constantly accelerating degradation of the environment and steadily declining standards of living;

- Weak marketing and private sector infrastructure;

- High level of unemployment and dependence upon migrant labor to the Republic of South Africa as its largest source of income;

- An educational system inadequate to provide relevant education and training at all levels; and

- Rapidly expanding population, which exacerbates problems in the areas of education, environmental degradation and unemployment.

B. Current Status

USAID/Lesotho's current bilateral project portfolio addresses a portion of the problems and constraints facing the country. The Basic and Nonformal Education System Project (BANFES), in place since 1985, is designed to improve educational efficiency through the provision of technical assistance and training to key Besotho educational institutions. The HRDA project training activities will concentrate on two key areas which support the Mission's development objectives but have not been adequately addressed by other projects:

- increasing the GOL capacity to manage scarce resources; and

- increasing private sector employment capacity to reduce unemployment and dependence on migrant labor.

Most of the institutions which support the private sector in Lesotho lack adequately trained staff to respond to the needs of small and medium sized enterprises. The HRDA project will provide training to strengthen the following institutions, all of which are directly or indirectly important for both export and entrepreneurship in Lesotho:

- Exporters' Association

- Lesotho National Development Corporation (LNDC)

- Trade Promotion Unit

- Lesotho Chamber of Commerce and Industry (LCCI)

- Basotho Enterprise Development Corporation (BEDCO)

- Business Extension Officers (BEO's) of the Ministry of Trade and Industry

The Lesotho Agricultural Production and Institutional Project (LAPIS), in place since 1985, is designed to: (1) increase production of high-value horticulture; (2) expand domestic and export markets; and (3) halt natural resources/environmental degradation.

A number of constraints and problems to private-sector development in Lesotho were identified by the MAPS team. Current and future assistance provided by USAID and other donors will likely attempt to reduce or eliminate some of these obstacles to private sector growth. Problems and constraints include:

- Need for collateral to obtain credit

- Lack of venture capital

- Poor production coordination on small-plot agriculture

- Land-tenure system

- LNDC thwarting Basotho entrepreneurial initiative

- Lack of information on Highland Water Development Project (HWDP) opportunities

- Moribound marketing division in the Ministry of Agriculture

- BEDCO problems result in a lack of microenterprise promotion

- Policy (inhibiting legislation) environment

- Poor management and technical skills

- Inadequate raw materials supplies for new agroindustry

- Government of Lesotho favors establishment of large-scale enterprises
- Lack of rural warehouses and collection depots
- Lack of cold-storage facilities
- Long-term capital for agriculture (collateral)
- Banks are too conservative
- Lack of short-term working capital for industry
- Underdeveloped markets (weak production incentives)
- Too heavy a concentration on staple crops
- Staple crops are not competitive with the Republic of South Africa (RSA)
- SACU agreement (open competition with RSA)
- Competition with subsidized state-owned enterprises
- Donor funding of state-owned enterprises
- Lack of entrepreneurial class
- Disorganization in Lesotho private sector
- Donors not supportive of HWDP because of RSA connection
- Underused plant capacity
- Lack of knowledge of modern technology
- Ineffec[illegible] donor projects
- Too much donor emphasis on agroindustries
- Insufficient rural banking facilities

C. Future Plans

The MAPS process has not been completed for USAID/Lesotho and so no recommendations have been finalized for strategies or projects in the private sector. An indicative list of options for activities which the Mission may want to consider has been prepared, however, as are "strategy articulation details". Many of these have at least indirect implications for export and entrepreneurship activities. The list of activity options includes the following:

- Help the World Bank design and implement lines of credit for the industrial and agroindustrial sectors -- The Mission should try to influence the choice of financial institutions that implement the lines of credit (preferably a commercial bank rather than the LNDC or the Agricultural Bank) and seek to persuade the World Bank to limit its loans to new industries or expansions where the controlling equity will be in indigenous hands.

- Help the GOL and other donors revitalize small-scale enterprise promotion activities -- The Mission should concentrate particularly on market-town and other new opportunities resulting from the Highland Water Development Project. Given that BEDCO is not a viable implementing agency, consider nongovernmental organizations and the Chamber of Commerce and Industry.

- Examine the reasons for success and failure of current (mature) private sector projects -- Other donor projects should be examined to the extent possible, and the results shared through an existing donor-coordination mechanism.

- Study the possibility of establishing a private sector venture-capital facility for indigenous entrepreneurs -- The lack of venture capital seems to be an almost universal constraint in less developed countries and has been noted frequently in he literature on Lesotho and by all the entrepreneurs interviewed by the MAPS team.

- Study Lesotho's present and projected marketing system and infrastructure -- Exisiting facilities, such as warehouses, cold-storage facilities, collection depots, and market points, may be inadequate and unable to support future increases in agricultural production.

- Investigate use and availability of non-Mission resources -- Programs in which AID has a stake, such as the Africa Project Development Facility (APDF/Nairobi), IESC, and EDESA (venture capital) might be coaxed into becoming more active in Lesotho. A volunteer with a U.S. Chamber of Commerce background from the IESC would be able to assist the Lesotho Chamber of Commerce in various ways.

- Investigate possible seed production and processing joint-venture -- A U.S. company and a Lesotho entrepreneur could participate in this venture. On first inspection, the idea makes great sense because AID has ample experience in this area, and it could be the way to get the first U.S. company to invest in Lesotho. AID might have to provide funds to make it work, but the return could be significant.

- Explore opportunities for privatization -- Use the AID IQC or AID/PRE's Privatization Project to explore privatization opportunities and develop privatization mechanisms in agriculture and agroindustry. The Minister of Trade and Industry, the Managing Director of LNDC, and the Minister of Agriculture have stated that they were ready to privatize various profitable or potentially profitable parastatals. The Minister of Agriculture has requested AID assistance to rationalize agricultural commercialization, including a look a privatization. Among the problems with privatization and divestiture that have been mentioned were inability to mobilize local capital in the private sector while ensuring that new ownership is not concentrated in a few hands. The MAPS team feels that this is more a problem of knowledge concerning capital mobilization methods than of a lack of private investment capital.

D. Indicative Requirements for Assistance

The trade and entrepreneurial development program which USAID/Lesotho proposes would have two aims:

(1) Assist in removing some of the obstacles current and potential entrepreneurs face in starting and expanding a business and to help them obtain suitable technical and managerial skills.

(2) Assist in identifying new business opportunities

The concept paper submitted by USAID/Lesotho differentiates between Small Business Development, Large Business and Policy Formulation.

Indicative Requirement #1: Small Business Development Center in LCCI

One main thrust of the program would be to assist in small business development by helping to remove obstacles which may be inhibiting the establishment and growth of small business in Lesotho. The approach to providing this assistance would be to contribute to the establishment of a Small Business Development Center (SBDC). This center would be responsible for providing development services to interested small businesses and prospective entrepreneurs. To complement these services, a Loan Portfolio Guarantee Program (LPG) would be established to assist small businesses in obtaining financial support.

It is proposed that the SBDC be established under the Lesotho Chamber of Commerce and Industry (LCCI), which would assume responsibility for insuring that a capable staff is in place which can provide the necessary services. These would include information and consultation services, mentor advisory services, marketing services, and referral services for technical and managerial training.

Information and Consultation Services would involve conducting an initial assessment of the client and his/her business proposal. As appropriate, the center would assist in constructing a business plan, conduct a more complete economic feasibility study as warranted, and provide training referrals.

Mentor Advisory Services would be aimed at utilizing the services of such groups as the International Executive Services Corp and Entrepreneurs International. By calling upon the services of experienced business people from the U.S., both of these groups can provide valuable assistance in business management, marketing and technical training.

The SBDC would also help their clients overcome marketing problems. These efforts would require marketing research capabilities which would be directed at identifying potential demand for locally produced goods and services in both domestic and foreign markets. The results of these research efforts could be used to serve the needs of the clientele of the SBDC and to assist in identifying new business opportunities. The Trade Promotion Unit, under the Ministry of Trade and Industry (MT&I), would assist in market research in foreign countries.

The SBDC would provide referral services to help interested parties in obtaining appropriate technical and managerial training. This would involve:

(a) identifying the skills which are needed; and

(b) exploring the country and region to locate the most cost-effective source for skills training.

These training courses should in most cases be short term (one to three months). In some cases technical training programs may need to be developed and the SBDC would assist local technical and managerial training institutions to adjust or create programs to fit the needs of the people.

It should be emphasized that the role of the Chamber of Commerce is to oversee that these services are being properly administered. Their staff would be directly involved in activities dealing with information, consultation, and marketing. The Chamber's involvement in the Mentor Advisory services and technical and management training is more of an organizer or advisory role. It would be responsible for contractual arrangements with appropriate institutions and organizations, but would not be expected to provide those services directly, unless there were no other recourse.

The SBDC's services should be available to any person, or group of persons, who wish to start a business in Lesotho. The initial assessment procedure will determine which enterprise proposals warrant further assistance from the center. Given Lesotho's present situation, special preference should be given to entrepreneurs intending to engage in productive (manufacturing) sectors, rather than the distributive sectors. Those who are presently involved in distribution and trade services may be a potential focus group. Another potential focus group might be the migrant workers who are seeking to invest in domestic production. Special promotion activities could be aimed at these two groups.

Over time it is expected that the SBDC would charge for its services in order to sustain itself. It is expected to remain a non-profit private organization.

Budget: **$200,000** *

* **This and subsequent budget figures are for a 3-year period**

NOTE: Most of the training would be in this component.

<u>Indicative Requirement #2</u>: Loan Portfolio Guarantee (LPG)

Another link in the Mission's program involves locating funding for prospective entrepreneurs. The Mission is presently working on a proposal to participate in the Loan Portfolio Guarantee Program which provides loan guarantees to financial institutions on loans provided to small businesses. By linking this program with the services provided by the SBDC, the Mission feels it would be providing a complete package which would greatly assist small business development in Lesotho.

Budget: $250,000

Indicative Requirement #3: Pre-feasibility Studies for Large Businesses through LNDC and MT&I

Support for large business activities would be provided mainly through USAID support to existing institutions and programs. Support for Pre-Feasibility studies would be provided through LNDC and the MT&I (most likely the Trade Promotion Unit). These studies would be aimed at (1) identifying the potential for joint venture investments, (2) commercializing and privatizing present government parastatals and projects, (3) expanding the potential of various agroindustrial ventures, and (4) exploring new investment opportunities for larger businesses (M 250,000 and above).

Budget: $200,000

Indicative Requirement #4: Mentor Advisory Program for Large Businesses

Services under the Mentor Advisory Program would be similar to those provided through the Small Business Center. However, the USAID Mission Γ ivate Sector Officer would be in charge of organizing these services.

Budget: $100,000

Indicative Requirement #5: Trade Promotion Unit Support

Assistance in export expansion would be directed through support to the Trade Promotion Unit and to the Export Finance Scheme. The Trade Promotion Unit would be assisted in expanding its market research capabilities, policy formulation, and public relations and trade promotion services.

Budget: $200,000

Indicative Requirement #6: Export Finance Scheme Capital Contribution

An [illegible] Finance Scheme in Lesotho, designed by the ITC of UNCTAD, is now in an early stage of implementation. This scheme provides short term guaranteed loans to exporters with secured contracts in an attempt to assist current exporters in expanding their markets. The Export Finance Scheme fits well with the matrix of options provided in the trade promotion program proposed in the RDSS. The Mission has some reservations about the ability of the central fund to re-capitalize itself, but feels a modest contribution to the fund is appropriate and would allow the Mission to monitor the management of the fund.

Support to the Export Finance Scheme would entail making sure that those firms participating in the scheme (or wishing to participate) would have full access to the other services provided in this program. The Marketing Advisory services may be the most appropriate of these. In addition, the program would include a one million US$ contribution to the Central Export Development Fund which backs the Export Finance Scheme. If there are doubts about the management of the central fund this contribution could be held on reserve until the demand for it was certain and the environment was suitable. Assistance to the Export Finance Scheme would be coordinated through the USAID mission Private Sector Sector Officer.

Budget: $1,000,000

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Indicative Requirement #7: Policy Formulation Assistance

Through its involvement in the private sector the Mission will give attention to the identification of government policy which may be seen as an obstacle to entrepreneurial development and to the promotion of policy recommendations aimed at assisting private sector growth. Considerable effort has been made by the Government of Lesotho to provide investment incentives aimed at attracting foreign investors and to enhance foreign trade by assisting in securing foreign markets for local producers.

Special focus may need to be directed toward government policy which specifically affects small businesses. A review of existing tax and licensing laws which pertain to small businesses may need to be reviewed. In an effort to assist local businesses in securing local markets it may also be necessary to consider short term trade regulations for particular goods imported from South Africa. The land tenure laws are also important to review from the perspective of both large and small businesses in Lesotho.

The Mission'. role would be to try to identify policy issues affecting entrepreneurship and trade development in Lesotho and to address them through the proper channels (most likely through the appropriate officials in the MT&I).

Budget: $250,000

NOTE: These funds will be used for buy-ins to centrally funded projects

Indicative Requirement #8: Private Sector Officer

The USAID Mission in Lesotho would hire a private sector officer to manage the program. The main function of the position would be to coordinate and direct USAID resources towards meeting the needs of the private sector. This would entail:

1. Working closely with the LCCI to ensure that the small business center was providing the proper services and making recommendations on how problems may be overcome.

2. Working closely with the financial institutions participating in the LPG

3. Working with LNDC and MT&I on pre-feasibility studies

4. Working with the Trade Promotion Unit and the Export Finance Scheme on trade promotion

5. Working to develop and revise the mission private sector strategy

6. Coordinating activities under the mentor advisory program

In most cases the job will require the officer to be a facilitator. Only in working on the Mission private sector strategy will he/she be required to do some analysis and research which may demand some degree of technical skill in economics, business management or marketing. To some degree this work could be contracted out.

Budget:
Staff Resources

Private Sector Officer; 2 years @ $40,000=	$80,000
PRE Staff Support (secretary); 3 years @ $15,000=	$45,000
Logistical Support to PRE Office: 3 years @ $10,000=	$30,000
Total	$155,000

NOTE: This assumes hiring local expatriate and already existing funds for first year of PSO.

TOTAL INDICATIVE REQUIREMENT COSTS	$2,155,000

E. Other Donor Activities

There is a considerable amount of donor activity in Lesotho and it is increasingly coming to bear on private sector development. However, the total value of assistance to Lesotho declined steadily from 1983 to 1986. In 1983 total aid was $224 million, more than halving to only $89 million in 1986. This changed only slightly, to $91 million -- divided between technical assistance of $74 million and $17 million in capital assistance -- in 1987. This represented a per capita level of assistance of $57.

The sectoral distribution of aid in 1987 was as shown in table 1 below.

Table 1
Total technical and capital assistance to Lesotho, by sectors
(in millions of US$)

	Capital Assistance		Technical Assistance		Total	
	$	%	$	%	$	%
General Development	0.1	0.8	4.2	5.8	4.4	4.9
Natural Resource			8.5	11.5	8.5	9.4
Agricult.,Fores. & Fish.	3.2	19.2	18.8	25.4	22.1	24.3
Industry	3.2	18.7	1.2	1.6	4.4	4.8
Transport & Communicat.	3.3	19.5	11.0	14.8	14.3	15.7
International Trade	0.5	2.9	1.2	1.6	1.7	1.8
Population			0.4	0.6	0.4	0.5
Human Settlements	0.2	1.2	0.7	1.0	0.9	1.0
Health	3.5	20.7	5.4	7.3	8.9	9.8
Education	1.5	8.6	20.6	27.8	22.1	24.2
Employment			1.3	1.8	1.3	1.4
Humanitarian Aid & Relief	1.4	8.3	0.3	0.4	1.7	1.9
Social conditions	*	0.1	0.2	0.3	0.2	0.2
Science and Technology			*	0.1	*	0.1
Total	17.0	100.0	74.0	100.0	91.0	100.0

* 0.1 million

Source: Reference 3

Technical cooperation was 81.3% of the total value of development cooperation reported for 1987. As a group, the United Nations System accounted for 28.6%, bilateral donors for 48.7% -- led by the United States followed by Sweden, Germany, Ireland, the United Kingdom and Canada -- and other multilateral organizations and NGO's for 22.7% of all technical assistance. The major donors for capital assistance in 1987 were (1) the World Bank (21.9%), the United Kingdom (16.7%), Denmark (16.4%), and the Federal Republic of Germany (15.9%).

In the sector of international trade the following project were reported for 1987:

- Trade and Tourism Promotion Program -- The EEC provided $771,000 over the period 1982-87 for provision of expertise to Lesotho National Development Corporation

- Technical Co-operation in Trade Promotion -- Over the period 1985-87 the UNDP provided $186,000 for a project co-ordinator, project support personnel and a UN volunteer.

- Export Finance Scheme -- $277,000 was planned to be provided by the UNDP during 1987-89 for a trade finance expert, consultants, fellowships and study tours.

- Technical co-operation in trade promotion -- The government of Norway and the ITC have provided funding for experts/consultants, fellowships, subcontracts and equipment over a 12 year period.

The UNDP New York office has strongly encouraged their local missions to become more active in private sector development and recommended quarterly meetings in Lesotho in 1988 to bring together the GOL and the private sector in order to define needs of credit, training, technical assistance, etc. These meetings took place last year and UNDP is now working on follow-up to these meetings which identified the following four areas in need of particular attention: (1) Financing for startup and working capital; (2) Training in business management and in technical areas; (3) Product development and marketing; and (4) Better communication between the public and privat tor.

The UN-funded ITC is very active within the Central Bank in developing its export financing scheme and is providing technical assistance to the Trade Promotion Unit. UNDP is a strong supporter (and the developer) of Lesotho's export finance scheme which the LNDC and others support strongly. Pauline Conway, a UNDP project development officer, indicated that other countries and organizations, including Botswana, Swaziland, the PTA and SADCC (particularly the PTA which would like to develop a regional scheme) are very interested in this export finance credit scheme. Other areas of UNDP involvement include:

- T/A support to the Trade Promotion Unit. Financing of this assistance comes from an ITC trust fund which Norway provides. This year and next the work in this area will involve exports of handicraft and mohair products.

- Institution building in the MT&I. This ministry has been weak and dominated by LNDC, according to Ms. Conway, and UNDP is providing T/A in the form of four technical experts who are currently at work in the MT&I. The ministry wants to strengthen its industrial project capability and has a priority list of 16 (fairly large scale) projects which it wants to see realized. It is also interested in setting up a risk fund similar in nature to the export credit scheme.

The UNDP has two priority areas:

- Rural development--including rural credit facilities and credit guarantee funds which they are working on in cooperation with Lesotho Agricultural Development Bank. If these are set up, the UNDP will likely provide T/A to help run the project development effort.

- Improvement of government operations and its ability to run the economy and to strengthen the private sector. This would include manpower development.

In terms of urban developments, the UNDP is helping to strengthen the Lesotho Bank so that it can increase its lending capacity. The possibility of establishing an investment equity fund is also considered. T/A will also be provided to the Chamber of C mmerce.

The United Nations Capital Development Fund (UNCDF) is assisting BEDCO in the construction of five rural workshops and in putting into place a loan scheme to finance productive activities. The UNCDF is expected to provide between $1.5 and $2 million to BEDCO and will also provide a technical expert to sit in the loan department of BEDCO.

The German Agency for Technical Cooperation (GTZ) has been very active in Lesotho and is considering a major technical assistance project with BEDCO in 1988, which would also include rehabilitation of Maseru workshops and the construction of a rural training center in Mafeteng. The Germans are currently involved in the woodworking program within BEDCO and have implemented the first in a series of pilot entrepreneurial development training workshops. The Lerotholi Polytechnic Institute (LPI) is also assisted by German aid.

According to the Lesotho Country Training Strategy report, the EEC program and orientation in general is increasingly focused on the private sector, and this is reflected in its activities in Lesotho. Competition between African countries to protect their market acccess to EEC markets has intensified, and the EEC anticipates that certain African countries will be disappointed by the Lome IV outcome.

One of the successful EEC projects in Lesotho has been the establishment of a cannery. The EEC is also heavily involved in the Lesotho Highlands Water project, both in the financing of the project design and in peripheral activities connected with the project. A consultant has been to Lesotho to look at marketing opportunities and microenterprise-development possibilities related to this water scheme. The EEC views that all collateral microcenterprise development related to this large project should be in private hands. The GOL is apparently not in agreement with this approach and is already planning a fisheries operation that would remain in government hands. In the mohair and wool area, the EEC is involved in price

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stabilization of mohair under their Stabex program. The EEC is also involved and has made available M1 million for the export-enhancement scheme approved by the GOL.

The EEC has confirmed its intention to provide a grant of over $9 million to Lesotho to implement a major manpower development and training project to support the Highlands Water Project. Training will be provided for technical and administrative skills for personnel who will work with the $2 billion water project. The EEC will fund construction and technical assistance at the LPI and the Lesotho Institute of Public Administration. Technical assistance will also be provided to the National University of Lesotho and certain GOL bodies.

The World Bank has provided major loans to LNDC and to BEDCO to finance their lending for enterprise development. The World Bank has reportedly been examining the possibility of making two lines of credit available to the LNDC, for industrial and agroindustrial projects. A loan of US$10 million may be available for this undertaking, with the industrial line possibly through the LNDC and the agroindustrial line through the Agricultural Bank. The lines of credit will assist rehabilitation, expansion, and new industry projects.

Beginning in 1 July, 1989, Sweden will make available to Lesotho a sum of Maloti 25 million for a two-year period. Sweden will continue to give support to public administration development, to environmental protection and soil conservation and to labor based works. Sweden will also give T/A to SADCC Coordination unit in Maseru for Soil and Water Conservation and Land Utilization. Forty Swedish and other experts work in Lesotho within the Swedish supported program. Around ten Basothos attend training courses in Sweden annually in a wide range of disciplines.

F. References.

1. Lesotho MAPS Report--Phase 1; Labat-Anderson Inc. and AID Africa Bureau, Office of Market Development and Investment (AFR/MDI); November 1988

2. Country Training Strategy--Human Resources Development Assis... Project (FY88-FY92); USAID/Lesotho; March 1988

3. Development Co-operation: Lesotho; 1987 Report; UNDP

BACKGROUND INFORMATION ON SWAZILAND

A. Background

In 1983, USAID/Swaziland's Annual Budget Submission identified the following major constraints to development: (1) low agricultural productivity on Swazi Nation Land, (2) rising Unemployment, (3) rapid Population Growth, and (4) high under-two mortality rate. These problems have provided direction for many of the development projects supported by the Swazi government, USAID and other bilateral or multilateral donors in the following years. While not explicitly or directly connected to exports or entrepreneurship, many of these projects and activities have significantly impacted these areas, in part because exports represent a very high share of total GDP in Swaziland.

Potential private sector exports have also been supported by USAID's stated commitment in 1983 and in subsequent years to increased involvement of the private sector in the development of Swaziland. In 1984, a Small Enterprise Support project was designed to encourage entrepreneurship in Swaziland, by encouraging the expansion and development of an indigeneous small enterprise private sector. This support was driven in part by the conclusion that Swaziland's Small Enterprise Development Company (SEDCO), a government parastatal charged with assisting the development of small enterprises in Swaziland, had been relatively unsuccessful in the expansion and training of Swazi entrepreneurs. The project encouraged Swazi entrepreneurs to move from traditional service-oriented enterprises into commercial and light-industrial operations, especially operations that process and market locally produced agricultural raw materials. The agricultural sector has been given substantial funding by USAID over the years, in part through the Cropping Systems Research and Extension Training Project, addressing production and marketing constraints facing the private sector in Swazi agriculture. In another large project, Commercial Agricultural Production and Marketing Project (with proposed funding of $11 million in the FY1989 budget submission), the export potential of different agricultural products, including fruits and vegetables, was planned as one part of the project.

Swazi private enterprise and entrepreneurship, as well as human resource development and training that would likely contribute to increased export activities in the long run, has been supported by the Mission's Swaziland Manpower Development Project (SWMDP). This was the largest part of the budget submission for FY1988. In the following year, money was requested for two small-enterprise projects which would directly assist the private sector with training as well as identifying business opportunities. These activities were planned to be augmented by PRE resources, for studies (with a business climate assessment already underway at that time) and other assistance aimed at the larger enterprises, including the agro-industrial sector.

B. Current Status

As a result of positive policy changes over the years, the country's commitment to a free enterprise economic system, as well as the payoff of various aid projects sponsored by USAID and other donors, the business environment in Swaziland is currently conducive to additional gains to be made towards greater private sector exports and entrepreneurship. This potential is further evidenced in the increasing international recognition of the favorable business environment which Swaziland offers. As a result, a recent OPIC mission yielded a positive response from U.S. investors, raising hopes for the future. One of the major constraints which both domestic and international business still face, however, is a shortage of middle-level managers and skilled workers. For this reason, the USAID's strategy continues to focus on human resource development. Most of the major projects in the Mission's current portfolio focus, either directly or indirectly, on this issue. And the new strategy which is beginning to emerge in response to the current environment will also be focused on human resource development.

The FY1990 budget submission reports on a number of other important aspects of the business environment and of USAID's programs and projects. This sets the stage for future developments in the area c˙ exports and entrepreneurship. The overall institution building phase of USAID's strategy is near completion and in a greater number of institutions a critical mass of trained professionals has now been reached, making it easier to work collaboratively with key instititutions (and groups of institutions) to address specific development constraints. This should favor further gains in stimulating export and entrepreneurship activities.

Long term participant training (in the SWMDP) has become heavily private sector oriented as both the government and private sectors have realized the need for training in management areas. USAID's ability to use the OPEX and short term consultants elements of the project to respond to important government requests has paid off handsomely. As a result of such assistance, the government set up a Public Enterprises Unit, which will monitor the performance of the parastatal sector and enhance the likelihood of making these units more efficient and privatizing some of them.

The work on MAPS have identified important features of the cu... Swazi business environment (in the form of both constraints and opportunities) that may influence future export and entrepreneurship activities. These features include the following:

- Two very distinct private sectors exist in Swaziland--that of large firms with over 100 employees and that with less than 25 employees. The key factors affecting the development of the largest firms are:

  - Low local labor force productivity

  - The (low) quality of government services

  - GOS policies, especially with regards to work permits and inability to carry tax holidays forward.

The key factors affecting the development of the micro and small enterprises are: (1) difficulties related to getting their product to market and (2) access to credit and capital.

C. Future Plans

As the MAP process is incomplete, the strategic perspective for future private sector action that will result from this process is not yet available. However, some "implications for dialog and strategy" have already been derived from the MAPS work already completed, and can have important influence on the direction of future projects and programs for USAID/Swaziland. These findings relevant for dialog and strategy include:

- Large and small firms have very different problems;
- The creation of relevant labor skill training in the country must be a priority;
- Small firms have virtually no access to formal credit sources, and survey results suggest that a major bottleneck for channeling credit assistance may be the lack of organizational infrastructure among the smaller firms;
- For small firms the most severe problems are perceived to be on the marketing side rather than production;
- There are effective business associations, but these do not provide the type of assistance most needed and wanted by the smallest enterprises.
- There is a need to create a greater number of lihnkages between the large and the small entrepreneur. Business organizations can play a key role here as well, by providing networking opportunities.

Because the business environment in Swaziland has improved signficantly, a window of opportunity now provides the potential to attract substantial foreign investment of a type appropriate to the nation's development needs. For this reason, the regional export and entrepreneurship project may help the USAID Mission leverage these positive changes into further gains in foreign exchange, jobs and overall level of welfare.

Since human resource development remains the greatest constraint to Swaziland's development -- and so identified in the FY1990 budget submission -- programs which address this sector will remain pivotal to the Mission's future strategy. If the trend over recent years continues, however, a larger share of activities addressing human resource development may involve the private sector more than in the past. Agriculture will remain the leading export sector but over time manufacturing will likely increase its share and receive additional assistance and better incentives for increasing exports. Expanded marketing efforts will be made in Southern Africa regional markets as well as in markets in Europe, North America and other regions.

Also, continued efforts will be made to improve public policy dialog, involving both the private and public sector -- and the traditional and modern sector of the economy -- as past efforts along these lines have yielded very positive results, raising hopes of additional gains in the future.

D. Indicative Requirements for Assistance

Six major potential areas of assistance from the EES project have been identified by the USAID Mission in Swaziland.

Indicative Requirement #1: Public/Private Policy Dialogue and Market Forces Encouragement

- Bring together government, traditional leaders and the private sector for dialogue sessions; create awareness among government officials and traditional leaders as to private sector and export sector (exports are 70% of Swaziland's GDP) needs and constraints, market forces, incentives for growth, planning for growth, problematic policy areas (taxes, work permits, incentives), benefits and problems competition, etc.;

- Expose key decision makers to other environments;

- Guide national environment to support trade-led industrial development;

- Coordinate cooperation with other donors

Budget:	($000)
A. Long Term T/A (coordinator); 3 years @ 125,00/yr	$375
Secretary ($20K/yr) + Office Support ($10K/yr.)	90
B. Short Term T/A @ $15,000/mo. (54 pers mos.)	810
(a) 3 persons @ 2 mos. ea./yr to provide advisory services to key policy makers; facilitate government involvement	
(b) 2 persons @ 2 mos. ea./yr to assist private sector and business organizations put together agendas	
(c) 2 persons @ 2 mos. ea./yr facilitating interests of small/micro businesses	
(d) 2 persons @ 2 mos. ea./yr facilitating interests and concerns of traditional sector	
C. Other: (a) Exposure trips to US (24 x $10,000)	$240
(b) In-country workshops/seminars/meetings/ 3 conferences/yr., media presentations	150
(c) Follow-up: reports & implementation plans	50
(d) National Convention on "Enabling Environment" with outside participants and panel members	100

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Indicative Requirement # 2: Export-oriented revolving credit fund for small and micro enterprises (Note that indicative requirements 2-4 are focused on reducing constraints to micro and small-scale enterprises)

- increase access to credit for informal/micro and small scale enterprises not available through formal sources in Swaziland; use successfuliy tested non-collateral based approaches.

Budget:

A. Other: Revolving Fund--three years	$ 1,000,000
B. Other: Administrative costs	200,000

Indicative Requirement #3: Start-up and growth of export-oriented small enterprises

- topic examples might be access to credit, identifying market opportunities, bulk purchasing, warehousing arrangements, transport, shared production centers, and others.
- consultancies directed at individual export businesses and groups of export businesses; the clients are the businesses themselves.

Budget:

A. Short term T/A (24 person mos. @ $15,000/ea.)	$360,000

Indicative Requirement #4: Access to Sites and Services for Small and Micro Exporters

- Two phases: (1) refine well-developed existing proposals and (2) provide funding for set up of micro and SEE hive industry park(s) focussed on export oriented businesses

Budget:

A. Short term T/A (phase 1) 3 mos. @ $15,000	45,000
B. Short term T/A (phase 2) 18 mos. @ $15,000	270,000
C. Other: Land, site preparation, provision of infrastructure, construction (phase 2); 2 sites @ $500,000 each	1000,000

Indicative Requirement #5: Export Business Representation and Business Associations

- Assist in formation and strengthening of institutional capacity of associations to serve their members of all sizes and sectors;

- Provide integration and linkages between small scale enterprises and larger businesses (horizontal and vertical integration);

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- Export-oriented feasibility studies at sectoral levels and above considering size, ownership and other factors; market analyses;

- Seminars and workshops in management and technical fields, employment services/listings.

Budget:

A.	Long term U.S. OPEXer 3 years @ $125,000/yr. (insitutional development, overall organiation)	$375,000
B.	Long term U.S. OPEXer 3 years @ $125,000/yr. (focus on problem areas, coordinate studies and analyses)	$375,000
C.	Long term Swazi/African Counterpart 3 yrs. @ $50,000/yr (big and small linkages and integration)	$150,000
D.	Short term T/A 18 mos. @ $15,000/mo.	$270,000
E.	Other: Printing, administrative, secretarial, training, workshops	$200,000

Indicative Requirement #6: Investment and Trade Relation Project with Government of Swaziland

- Multi-ministerial integrated coordination to increase trade and exports;

- Focus on high growth potential sectors: marketing, services, tourism, textiles, manufacturing, SNL irrigated/commercial agriculture, SNL secondary activities;

- Technical assistance at the Minstries of Agriculture, Finance and Commerce.

The three OPEXers will be responsible for:

- Assisting in institutional development of TPU at Commerce, Trade policy at Finance, and export-oriented agriculture and value-added agro-processing at the Ministry of Agriculture;

- Liasing with business associations in coordinating support (micro/small) exporters;

- Assisting in coordinating feasibility studies addressing market access, export opportunities, the regulatory framework (taxes, customs, permits, investment incentives, duty free zones, dry ports etc.) technology development center, increasing output and value-added from SNL crops and products;

- Assisting micro and small exporters help sell their products: access credit to increase scale, monitor and support quality control, promotion and marketing, provision of printed materials and technology access;

- Strengthening Trade. Promotion Services of the TPU: Availability and development of documentation and literature, distribution above;

- Coordinate training for exporters and GOS officials involved in export promotion activities;
- Assisting in technology development and transfer, eg. linkages with sources and dissemination of SSE appropriate and industrial technologies;
- Arranging Entrepreneur exposure trips to the US;

Budget:

A. 3 long term U.S. OPEXers	9 years @ $125,000/yr	$1,125,000
B. Short term T/A	36 mos. @ $15,000/mo	540,000
C. Other: Training/travel/printing/workshops		300,000

<u>Indicative Requirement #7</u>: Trade and Entrepreneurship PSC in AID Mission

Budget:

A. Long term PSC ($125,000/yr)	$375,000
B. Administrative/Logistical support ($20,000/yr)	60,000

<u>Indicative Requirement #8</u>: Foreign Co- and Joint Venture Development

- Assist U.S. businesses investigate and start-up commercial operations in Swaziland; follow and coordinate regional interests;
- Promote existing high-quality Swazi products as inputs to foreign companies to provide technology-based value-added for export;
- Feasibility studies, business plans, funding shipments of supplies, product samples, product prototypes, promotion, information dissemination;
- Work with US Embassy Commercial At[illegible], AFR/MDI, PRE; coordinated by Trade and Entrepreneurship PSC;
- Research Opportunities in European Markets (Lome);
- Pre and Post OPIC mission support;
- Possible use of IESC trade and investment service; and
- Possible link with Swaziland Industrial Development Corporation.

Budget:

A. Short term T/A (18 mos. x $25,000/mo) (higher T/A costs include company fees) (could possibly share a Southern African Regional LTTA with Lesotho and Botswana, if appropriate)	$ 450,000

B. Other: Travel (w/in Africa and to and from US) 12 trips/yr x 3 years @ $5,000 ea. + $20,000 for Southern Africa regional travel. Trips are for US Advisor, US firms, European firms and selected OPIC participants — $ 200,000

BUDGET TOTAL:

A. Long term T/A	$2,925,000
B. Short term T/A	$2,745,000
C. Other	$3,440,000

E. Other Donor Activities

Total "externally financed technical cooperation" in Swaziland rose from $17.5 million in 1983 and has stayed around $22-24 million in the period 1984-1987 (data are not yet out for 1988). In 1987 almost half of this aid was channeled to the education sector (49.1%), followed by agriculture (15.0%), Health (11.8%), General Development Issues (5.8%) and the Transport and Communications sector (4.5%). Thus, the distribution of aid to the above sectors is generally in line with the objectives of the Fourth National Development Plan (1983/84-1987/88) which calls for priorities in education and health. Further, with Swaziland having a major potential for employment based on cash cropping and livestock, and in view of the fact that agriculture is the dominant sector within the Swazi economy, interest in this sector by external donors is very high.

Bilateral programs dominate as the source of funds for technical assistance, providing $ 16.8 million in 1986 and $19.5 million in 1987, while multilateral programs only contributed $4.3 million and $1.7 million in 1986 and 1987 respectively. Among the bilateral donors, the U.S. led in both years with $9.1 million (1986) and $10.9 million. The next largest donors for technical assistance were the United Kingdom ($3.2 million and $3.3 million) and Canada ($2.8 million and $1.3 million). The only other country with bilateral aid exceeding $1 million in 1987 was West Germany with $1.[illegible] million (no figures avaiable for 1986).

The leading multilateral donors in 1987 were: (1) UN: $1.7 million (versus $4.3 million in 1986); with UNDP responsible for between $700-800,000 of this in 1986-87; (2) the EEC: $1.5 million in 1987; and (3) the European Development Fund with $800,000 in 1987.

An examination over the period 1983-1987 indicates that total Capital Assistance has varied over time, declining somewhat after peaking in 1985. Over this period the loan component of Capital Assistance has declined, the grant component has been variable and the equity component has been increasing steadily. In total, capital aid reached about $32 million in 1987, down from $40 million in 1983.

Bilateral aid again provides the bulk of the funding for capital assistance, or $20.9 million in 1986 and $22.4 million in 1987, while

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multilateral programs provided $4.1 million in 1986 and $9.8 million in 1987. In 1987, West Germany provided the great bulk of the bilateral Capital Assistance with a total of $15.3 million, followed by a distant second of the Republic of South Africa with $4.5 million and the UK with $1.4 million. Among the multilateral donors, the European Development Fund led the way with $7.4 million -- up from $3.8 million in 1986 -- while the UN organization of IFAD (International Fund for Agricultural Development) provided the next largest share of the funding, with $6.2 million in 1987, followed by the UN organization World Food Program.

Among the largest projects/activities funded under Capital Assistance, are the following:

- A loan/credit of $9 million from UK/CDC for a Natex Weaving Plant;

- $7.7 million in equity committed by the (West German) Finance Company for Investment in Developing Countries in SIDC;

- A $6.2 million loan/credit by IFAD/FAO for Smallholder Credit and Marketing Project;

- A loan/credit of $4.5 million by the RSA for road construction; and

- A loan/credit of $4.5 million for a rural health center.

No identification of export and/or entrepreneurship oriented projects or programs funded by multilateral or bilateral donors is possible from available data. A growing share of assistance is likely targeted at the private sector, however, and all UNDP offices are now strengthening their dialog with the private sector and with the government about the private sector. The UN has also been very active in assisting governments in their trade promotion efforts, although the effectiveness,and impact of this effort is not clear.

Examples of externally funded technical cooperation projects and activities in international trade and development finance are summarized below.

Project/Activity	Source of Funds	Cost of Assistance	Time Period	Nature of Assistance
1985				
Assistance to Swazi Development and Saving Bank	EEC	$189,000	1982-87	T/A for improvement of internal organiz.
National Marketing Scheme	FRG	$479,500	1985-	Consultancy and Possibly training and equipment
1986				
Promotion of Business Cooperation	FRG	$95,000	1985-88	T/A

Project/Activity	Source of Funds	Cost of Assistance	Time Period	Nature of Assistance
1986 (continued)				
Provision of Experts	IMF	--	1986	Provision of 3 experts to Central Bank
Trade Promotion	UNDP	$194,217	1986-88	Export Promotion Advisor, Study Tours Equipment and Misc.
1987				
Advisor to Business cooperation	FRG/GTZ	$1.15 mill	1985-88	
Swaziland Finance Project	US Peace Corps	--	--	Technical assistance to Ministry of Finance
T/A to Integrated Development of Trade, Tourism and Handicraft	EDF	$250,000	-1987	Trade, Tourism and Handicraft
T/A to Central Bank	IMF	--	1987	T/A by 3 Central Bank experts
T/A in Trade Promotion	UNDP/ITC	$239,000	1986-89	Trade Promotion Advisor, study tours, Equipment and misc.

F. References

1. Development Cooperation: Swaziland; 1987 Report; UNDP

2. Annual Budget Submissions: Swaziland; 1986-1990; USAID

3. Draft Papers of MAPS/Swaziland

4. A Description of the Private Sector in Swaziland; Report on MAPS Phase II; April 1989

5. Investment Climate and Private Sector Assessment of the Kingdom of Swaziland; Dimpex Associates; July 1987

BACKGROUND INFORMATION ON MOZAMBIQUE

A. Background

The serious deterioration of Mozambique's economy in much of the 1980s seriously undermined both export and entrepreneurship activities in the country. The decline of the economy since 1981 has been characterized by a collapse of domestic food production and marketing, causing a chronic lack of adequate supplies of basic commodities to the urban centers, which became dependent on international support since that time. A similar decline affected export trade, with the result that marketed export production was one fourth of the 1980-81 level for the major export crops. Illustrative of this situation was the collapse of exports of agricultural commodities, including sugar and citrus fruits, from the province of Sambesi which used to supply a large share of exports from Mozambique but which now is cut off from transportation linkages because of insurgency.

Two major sources of foreign currency -- remittances of miners working in South Africa, on the one hand, and transit fees from bordering countries which used to rely on Mozambican ports and railway facilities for their maritime trade, on the other -- col apsed completely in the first part of the 1980s, even though improvements have been seen in the transit trade, especially from both Zimbabwe and South Africa over the last couple of years.

At its Fourth Party Congress in 1983, FRELIMO (The Front for the Liberation of Mozambique) called for greater emphasis on pragmatic policies, and a more liberalized and market-oriented economic approach, representing a clear shift away from the rigid, socialist, centrally-planned economic model which until then had characterized government policies.

The new policies, which are slowly making it more attractive for the private sector to operate and generate greater exports and help stimulate entrepreneurship have included the following elements:

- Price liberalization, thereby stimulating greater private sector production;

- Shift in policy emphasis from state fa[illegible] private agriculture as well as from heavy to light industry, and from major investments to rehabilitation and maintenance;

- Greater encouragement to private sector activities and foreign investment;

- A foreign exchange retention scheme which allowed selected exporters to retain a variable portion of their export revenues in order to import inputs for further export production;

- A revised labor law providing greater autonomy for enterprises to dismiss workers for economic reasons and to introduce wage differentials for more productive workers; and

- Authority for selected agricultural export enterprises to engage in external trade without using a parastatal trading company.

While these policy changes represent a move in the direction of positive economic reform, they have failed to address many key policies which were contributing to the inefficiencies and decline of the country's economy. In 1987, the GPRM announced its Economic Recovery Plan (ERP) which covers 1987-1989. The ERP is designed to address the macroeconomic and sectoral policies which have constrained the performance of the economy, and has received the support of both the IBRD and the IMF. The general approach of the ERP is to reduce the influence of centralized administrative controls in the economy by allowing market forces to play a greater role in determining the allocation of resources, income and performance of economic units and individuals.

USAID has contributed signicant assistance to Mozambique through bilateral technical and capital cooperation. In 1987 the United States contributed over 22% of all capital assistance for humanitarian aid and relief. Technical assistance funds have been provic d to assist Mozambique to address critical needs in training and advisory services required for private sector development and increased food production. This was part of phase I and II of the Private Sector Rehabilitation program. This program was initiated in 1984 and marked the first development-related effort of the United States and the GPRM. Overall, the program was intended to support the GPRM's policy initiatives in revitalizing private sector activities, especially in food production, and encouraging its expanding cooperation with the West. The U.S. goal was, and is, to have Mozambique achieve long-term growth and development based on sound market-oriented principles in order to promote stability in Southern Africa.

B. Current Status

The policy environment in Mozambique has continued to improve, according to an IBRD assessment in March 1989, as major progress has been made acr ' an impressive range of policies and significant steps have been taken towards removing the centralized administrative controls over the economy. Examples cited include the exchange rate, fiscal stabilization, price and distribution decontrol, and sectoral reforms in agriculture and industry.

Nevertheless, the need is noted for additional gains in the areas of interest rates, remaining price controls, the rather tentative approach to enterprise subsidy reduction, financial sector reform and the broadening of trade liberalization. Efforts to achieve many of these goals were included in the third annual arrangement under the three-year structural adjustment arrangement between the IMF and the GPRM.

USAID's support to improvements in Mozambique's economy includes Public Sector Rehabilitation (PSR) V, the fifth phase of AID's bilateral involvement in Mozambique. The purpose of the program is to provide support for the private agricultural sector to increase its production through importation of vitally needed inputs and equipment. PSR V also supports the goals of the Economic Recovery Program of Mozambique.

The PSR Commodity Import Program provides foreign exchange for the provision of otherwise unavailable agricultural commodities for private sector farmers and raw materials for the local manufacture of commodities needed in the agricultural sector. The Phase V program continues to support the GPRM's policy trend towards private sector development by providing resources which will help these new policies succeed and by encouraging movement toward a market economy. AID provides foreign exchange costs, and the GPRM provides associated local costs.

Other assistance which USAID has provided which gives direct or indirect support to private sector exports and/or entrepreneurship include:

- Assistance and support for the establishment of AEPRIMO -- a private sector business association and consulting organization whose members are small firms in need of training, capital and equipment. USAID is now about to sign a contract for technical assistance to provide organizational development and bookkeeping for AEPRIMO.

C. Future Plans

If the progress in policies over the last few years continues -- and with persistent pressures by bilateral and multilateral donors for policy liberalization -- private sector exports and entrepreneurship should also continue to benefit, even if slowly. USAID has concluded, however, that the time is not right to pursue any major new projects or programs in these areas, in part because the government is still sensitive to rapid policy changes or initiatives which are clearly targeted at, and primarily benefitting, the private sector, particularly if this may lead to greater role for foreign investors in certain sectors.

For the next few years, therefore, exports and entrepreneurship will be supported mostly indirectly through other programs which USAID is continuing and initiates. Such an approach will also give the Mission greater flexibility to act on "targets of opportunity" which appear on short notice, and often [illegible]ted by unexpected external events. Examples of opportunities that may allow USAID to support greater private sector participation includes potential privatizations of parastatal organizations. Such assistance may be provided through T/A to help the GPRM in evaluating the opportunities and procedures for privatizing parastatal organizations, possibly involving debt-equity swaps.

USAID may also be able to provide useful assistance to the Office of Foreign Investment in the Prime Minister's Office, either through constructive dialog on policy or technical issues. Focus on particular sectors have allowed certain donors in the past to have greater impact. In the case of the sugar industry, for example, the World Bank, followed by the Kuwait Fund and the Africa Development Fund, achieved considerable success in influencing events in this sector by having a clear and specific sector focus.

The FY1990 Annual Budget Submission of USAID describes two new project proposals which would have at least indirect potential impact on exports and entrepreneurship. The Private Sector Support project is fundamentally a continuation of the successful Private Sector Rehabilitation program, but with more of an emphasis on sectoral problems and on ensuring that the mix of commodities has the higest poetntial of value added in the country, especially for earning foreign exchange. The focus is not on exports, however, but on increasing domestic private sector agricultural output to meet primarily domestic demand. This would be achieved through the importation of agricultural inputs, and capital equipment to the private agricultural sector. The program will also provide raw materials to private factories for the manufacture of agriculture related tools, implements, and inputs.

The second new project proposal intends to improve the capacity of the private sector to contribute to economic growth by generating increased foreign exchange through expanded exports and by rehabilitating the construction and building materials industry in preparation for privatization. The Private Sector Development Fund, to be administered through a commercial bank, will have two windows. For exporters participating in the southern Africa regional Pre-Export Revolving Fund, foreign exchange will be available to purchase capital equipment for export manufacturing.

For firms in the construction and building materials industry, etc., access to the Fund will require companies to submit detailed business plans and their latest audited accounts together with the counterpart local funds equal to the foreign exchange requested. The counterpart funds can then be used to develop small and medium scale enterprises in this sector, for example plumbers and electricians. Companies capable of earning foreign exchange would repay a portion of their foreign exchange earnings back to the Fund.

D. Indicative Requirements for Assistance

Indicative Requirement #1: Support for AEPRIMO

AEPRIMO is a newly created business organization that aims to be a representative voice of the private sector to the GPRM and to provide services to the business community

a. Basic Institutional Support

Budget: $100,000 in first year of project

b. **Installation costs for the Process Technology Data Base developed by VITA at AEPRIMO; A data base for appropriate technology for Mozambique manufacturers**

Budget: $100,000 in first year of project

c. Support for the creation of a management consulting Division which eventually is self-sustaining

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Budget:

(i) Expatriate Team Leader: 1 p.y. in 2nd year of project
0.5 p.y. in 3rd year of project

(ii) Expatriate Marketing Expert: 1 p.y. in 2nd year
0.5 p.y. in 3rd year

Total budget: $550,000

d. Support of courses conducted by international experts, offered by yet to be created training unit

3 courses in 1st year
6 courses in 2nd year
9 courses in 3rd year and 4th year

Total budget: $1.05 million

Total budget requirement for component 1: $1.7 million

Indicative Requirement #2: Support for GPIE, the Office for Foreign Investment Promotion

OPIE must analyze and approve almost every foreign investment proposal (all of which have foreign exchange generating components) for Mozambique. Their analytical capability is very low; staff are being trained now but are very inexperienced.

Budget:

a. Two OPEX advisors starting 6 mos. into the 1st p.y., continuing through the life of project (3 or 4 years)

Cost: $875,000

b. Short term specialist T.A.--Export Processing Zone Development

Prefeasibility: 2 months	lrst p.y.	Cost:	$ 60,000
Design and Siting: 6 mos.	2nd p.y.;	Cost:	$180,000
Development: 6 mos.	3rd p.y.;	Cost:	$250,000

Other nonspecified short term T.A. 3 mos. in each p.y.

Total cost of component 2: $1.655 million

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Indicative Requirement #3: Support for the key components of the program of action for the National Directorate for Foreign Trade Operations (NDFTO)

The NDFTO, under the Ministry of Commerce and Industry, is the government export promotion body. The Ministry is poised to accept a private sector market oriented trade policy and program of action for the NDFTO (developed with the assistance of Commonwealth Development Fund advisors--draft not available until officially accepted)

Budget:

a. Export Promotion OPEX Advisor 1 to 4 years:	$175,000
b. Trade Information and Documentation OPEX Advisor 1 to 4 years:	$175,000
c. Short term T.A. made available to private sector firms with promotion needs; 4 mos. per year starting in 2nd year:	$240,000
	$590,000

Indicative Requirement #4: Support for Private Truck Leasing Firm

The Mission has perceived a need for helping to establish a private sector truck leasing unit that would lease trucks to private sector haulers.

Budget:

A. Prefeasibility study; 1 month lrst p.y.;	Cost: $30,000
B. Feasibility Study; 3 mos 2nd p.y.;	Cost: $90,000
C. Truck Imports; 3rd p.y.;	Cost: $1 mil.
D. Spare parts imports; 3rd p.y.	Cost: $0.4 mil.
Total cost	$1.52 mil.

Indicative Requirement #5: Priva ector Coordinator to help design, monitor, and plan new project activities

P.S.C. international recruit for all 4 years of project

Budget: $525,000

Total Cost for all 5 components: $6.0 million

E. Other Donor Activities

The volume of development cooperation from external sources to Mozambique in 1987, as reported to UNDP, totalled US$902.6 million (US$217.6 million more than in 1986), divided into $168.5 million in Technical Assistance ($56 million more than in 1986) and $734.1 million in Capital Assistance ($161

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million over the 1986 figure). On a per capita basis the total external financial assistance amounts to $62.2, or $11.6 per capita in T/A and $50.6 per capita in capital assistance.

Bilateral donors accounted for the biggest portion of all externally supported development activities -- funding 76% of all T/A and 85% of all capital assistance. Italy led the way with $23.2 million in T/A and $112.2 million in capital assistance -- $73 million of the latter going to humanitarian aid and relief, exceeding even the US assistance in this area of $66 million. The largest donor of T/A in 1987, however, was Sweden with $43.8 million in assistance, followed by Italy and the Netherlands (the latter with $21.1 million) and the Soviet Union with $9 million.

The bulk of bilateral T/A, or 37.6%, was targeted at the transport and communications sector, followed by the agriculture, forestry and fisheries sector with 21.5%. Health received 11.4% of the funding while industry and International trade and development finance received 10.2 and 0.2%, respectively.

In capital assistance the largest donors following Italy and the United States were: Sweden ($50.9 million); United Kingdom ($41.2 million); Soviet Union ($38.8 million); France ($30.4 million); Norway ($29.8 million); and the Netherlands ($29 million)

The UN system, the World Bank and the IMF provided approximately $91 million in development assistance, of which 35.5% was in form of T/A. This assistance represented almost 19.2% of all technical cooperation in value. UNDP and UNICEF represented the biggest providers of T/A among the multilateral agencies (approximately 73.4% of multilateral T/A in value)

Capital assistance was focused on supporting the economic rehabilitation of the country, mainly in agriculture, industry and transport. In order to stimulate agricultural recovery, external assistance was used to provide essential tools, seeds, extension services and rehabilitation of infrastructure. In the industrial sector, external capital support conce[illegible]ed its efforts on rehabilitation of the physical productive facilities and increase of capital utilization by provision of imported inputs. Such assistance helps to raise the current and future export potential of the country as well as providing an environment more conducive to private sector entrepreneurship.

In the transport sector, the overriding concern was the rehabilitation of the ports and railways linking Mozambique with the neighboring countries. However, the progress in this sector depends on the evolution of the security situation, as the continuous disruption and sabotage of communciation lines have been the major cause of delays in this area.

In view of the persistence of these security problems, and their consequences on the local production of food and other basic commodities, humanitarian aid and emergency relief represents a major component of external assistance to Mozambique, providing essential support to large sectors of the Mozambique population for the provision of basic products.

The most active bilateral donors of humanitarian aid and emergency relief in 1987 were Italy, the United States, the United Kingdom, the Nordic countries and the EEC, representing almost 65% of the total bilateral emergency relief. Among the multilateral agencies, the most active in emergency relief were UNICEF, UNDRO, WHO and UNDP. In the 1988 emergency appeal to the international community the government estimated that a total of $333 million were required for the year in 1988 in terms of emergency relief, of which $183.4 million for food aid needs.

On general support to the overall process of development, the Consultative Group meeting held in Paris in November 1988 estimated gross external financing requirements at $1.1 billion for 1988. According to preliminary estsimates $722 million (out of these requirements) were already available at that time: 48.5% through multilateral flows and 51.5% through bilateral channels. Concerted actions in form of debt relief are expected to cover the difference of $426 million.

The CG reiterated the support of the international community to the efforts made by Mozambique to restore conditions f growth. Substantial balance-of-payments support, debt relief, and other forms of external financing are expected to assist the Government of Mozambique in its actions.

F. Reference Documents

1.USAID Annual Budget Submission; FY 1990: Mozambique; May 1988

2. Development Cooperation Report--1987: Peoples Republic of Mozambique; UNDP; December 1988

3. People's Republic oo/Mozambique--Structural Adjustment Facility: Third Annual Arrangement; IMF; March 29, 1989

4. USAID; FY 1987 Mozambique Private Sector Rehabilitation IV--656-0201C

5. USAID; Mozambique FY 1988 Private Sector Rehabilitation V--Program Assistance Approval Document--656-0201C

BACKGROUND INFORMATION ON TANZANIA

A. Bacground

The most important event following the independence of Tanzania, and which has shaped the economic, social and political evolution of the country until recently, was the Arusha Declaration of 1967. It spelled out President Nyerere's foundations for Tanzania's socialistic path to development and his vision of destiny for the population. This policy choice also had a major influence on which countries were to become the leading aid donors to Tanzania -- giving the Nordic countries a leading donor role -- and in this way helped stimulate and reinforce President Nyerere's socialist policies.

Within 24-hours of the Arusha Declaration, banks and insurance companies were nationalized. The government took over most industries, large farms, and many commercial buildings. In 1973 government parastatals numbered only a few dozen, but increased to over 400 by the end of the decade.

A combination of domestic policies and external events converged to turn an economic decline of the 1970s into a crisis of the 1980s, characterized by a severe drop in export revenues, rapidly rising external debt and debt services, increasing imports and balance of payments deficits, and rising fiscal deficits from rising social expenditures combined with reduced revenues. This series of events helped make Tanzania, as was the case with a number of other African countries as well, increasingly dependent on donor assistance, in turn leading to its own distortions in policies and institutions in the country.

USAID/Tanzania's history can be divided into four periods, according to USAID's draft CDSS, with each period reflecting the development priorities set by the Tanzanian government:

(1) A period starting in the 1960s addressed the need of a newly independent country with a very limited number of trained people. The AID projects in this period were directed towards training needs in a wide range of fields, and in some instances towards physical investments in educational institutions. A secondary focus was on physical infrastructure for roads and water.

(2) Starting in 1967 with the Arusha Declaration, the country's development plan was focused on agriculture, and the Mission's programming moved from broadly based manpower training to support for agricultural development. Transportation infrastructure was a secondary focus area with health education as the third priority area.

(3) From 1978 onwards the primary thrust for USAID programming was on rural development. But major health programming continued with a large School Herallth project and others, and follow-up activity to the Agricultural Research and Seed Multiplication projects were funded.

(4) A final period began in the early 1980s as Tanzania's economic crisis deepened following the oil price increase in 1979. During this period,

attention was directed towards the role that government policies were playing in contributing to the crisis. USAID began bilateral discussions with the Treasury in 1982 and 1983 by associating food aid with policy changes that could boost agricultural production and reduce dependency on donor provided food. In the same year, the government undertook a structural adjustment program to address the worsening crisis, but the measures were not powerful enough to enable the government to meet financial obligations of the early loans. Therefore, Brooke restrictions were applied in early 1983, prohibiting USAID from obligating any new funds for Tanzania. As a result, USAID began the process of phasing down its projects.

In 1986, the "Paris Club" reached agreement on debt rescheduling, thus paving the way for the rescheduling of the US debt and the lifting of Brooke Restrictions in April 1987. Programming since 1986 has continued to be based on a commitments to policy dialogue with support for economic policy reforms, particularly as they pertain to transportation constraints in the rural areas.

Considerable PL 480 Food aid has been provided to Tanzania. The FY1987 program involved 25,000 MT of wheat flour, generating $7.7 million of local currency for the rehabilitation of rural transport primarily. The FY1988 program provided 10,000 MT of wheat flour for the Mainland and 5,000MT of rice for Zanzibar, and generated $5.5 million of local currency for rural transport, agricultural marketing and production, food emergencies and AIDS control. Policy measures of the two programs have focused on food pricing policies, reduction of food and import subsidies, and the test of "right of first refusal" policy involving the private sector in food aid distribution and food program coordination.

B. Current Status

In an attempt to learn from the past, current programming has tried to maintain a primary focus on the transport sector with a particular emphasis on rural feeder roads. Although the health and social implications of an expanding population and the alarming increase in HIV positive cases has drawn USAID programming into these areas, they will ramain a secondary focus. The focus on transportation and on a limited number of selected activities has quantitative definition. During FY1987-89, 90% of U.S. assistance has been committed to transportation, 6.4% to food aid, 1.6% to AIDS and family planning, and 2% to training.

One lesson learned again and again is that USAID must sustain support for a few chosen activities for many years in order to see significant development impact. USAID also feels strongly about a clear focus for its activities and avoiding "scatterization" of its efforts in order to facilitate management and implementation of projects without straining staff.

This philosophy, together with the Mission's concentration on transportation projects and policies, has limited the mission's scope of direct private sector export and entrepreneurship activities. Considerable effort has gone into promoting the private sector's role in the Tanzanian economy, however, both through explicitly increasing its participation in USAID aid projects and via promoting macro and microeconomic policies that stimulate private sector activities.

Since severe transportation constraints represent one of the most serious obstacles to increased exports from Tanzania, it is clear that the great bulk of USAID's program efforts has helped create the physical infrastructure necessary for increased private sector exports, and will continue to do so in the future.

C. Future Plans

USAID has dedicated itself to a new way of doing business. Its policy-driven program, under the new Development Fund for Africa, will be performance oriented. It will eschew quick results in favor of long-term sustainability following a systems rather than a project approach. Activities will concentrate in a few key areas and, to the extent possible, be integrated, both programmatically and within the overall national context.

The new style means that the assistance level each year will be determined by judgements about Economic Recovery Program (ERP) policy performance. Program c ligations will continue to be determined by assessments of effectiveness and absorptive capacity. New programs will not be justified and designed to simply absorb the annual dollar planning levels.

During the CDSS period USAID expects to see increases in the shares of funding allocated during 1987-89 to family planning and for training. A significant increase in funding for training is consistent with the Mission's commitment to projects which can yield significant long term payoff. In view of the serious shortage of highly trained personnel in both the private and public sector in Tanzania, increased funding for scholarships for training in domestic and foreign academic and vocational institutions promise to significantly strengthen the "enabling environment" in the country and thus facilitate a continuation and strengthening of policy design and implementation. This in turn will benefit private sector export and entrepreneurship.

Some of the avenues which USAID/T [illegible] seek to expand indirect assistance to enhance Tanzania's own capacity to foster reform, contained in the CDSS draft, include:

- The strengthening of the Chamber of Commerce, Industry and Agriculture in its substantive function of promoting private sector indigenous entrepreneurship and continuing dialogue with the government of Tanzania;

- The increase of local currency generation programmed for use in the private sector, particularly in rural roads transport network

- The training of indigenous male and female agribusiness entrepreneurs as a nucleus for future private sector development;

- The promotion of ties between US and interested Tanzanian firms; and

- The continuation of policy discussions with the government of Tanzania that emphasize dismantling of the loss-making parastatals and reducing or eliminating the remaining distortions in the areas of foreign exchange allocation, financial institutions, marketing boards, credit, and the exchange rate.

D. Indicative Requirements for Assistance

The Mission is only interested in minor assistance in the first few years of the project, primarily in form of T/A (from regional master contractor in Harare) for policy formulation and possibly some technical assistance to export-oriented businesses.

Indicative Requirement #1: Policy Formulation Assistance

Budget: $

Indicative Requirement #2: Assistance to Export-oriented businesses

Budget: $

E. Other Donor Activities

Total foreign assistance flows to Tanzania in 1987 (the last year for which comprehensive data exists) was reported to be $764.4 million, excluding emergency relief and humanitarian assistance of $14.9 million. The magnitude of this assistance in the context of the Tanzanian economy, and its implications for distortions of institutions and policies in the country as a result of aid dependence, can best be understood when comparing the aid flows to the country's total exports of only $350 million in 1987.

While substantial in relation to its exports, Tanzania's total aid is smaller than the $902.6 million received by Mozanbique in 1987. On a per capita basis, Mozambique's assistance looms even larger, as its per capita aid of $62.2 is nearly double that of Tanzania's $33.9, the latter divided into technical assistance per capita of $12.3 (slightly exceeding that of Mozambique's $11.6) and a capital assistance per capita of $21.6 (much smaller than Mozambique's $50.6)

In comparison, total flow of external assistance to Tanzania in 1986 was reported to be $646.6 million, exclusing humanitarian aid and relief of $23.4 million. Thus, the total reported aid flow (excluding humanitarian aid and relief) increased in 1987 by 18.2% or $117.7 million. However, this does not necessarily reflect a similar increase in aid flows in national currencies of the donors, due to the general decline of the dollar against major currencies in that year.

Technical assistance increased in 1987 by $29.7 million, or 12.3%, to $281.9 million. The largest share of T/A is captured by the following sectors: (1) Agriculture, forestry and fisheries ($73.1 million); (2) Transport and Communications ($42.8 million); (3) Health ($42 million); (4) industry ($38.5 million); and (5) Natural Resources ($20.9 million). The most significant increases in 1987 took place in agriculture: $17.8 million or 32.1%; transport: $24.1 million or 49.3%; industry: $17.6 million or 48.5%; and Health: $20 million or 89.1% (It should be noted, however, that changing definitions of aid categories complicate intertemporal comparisons of aid statistics).

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Capital assistance increased by $87.6 million, or by 21.7%, to $497.3 million in 1987. It is most likely that capital assistance increased even more, as about 25% of disbursement reported in the 1986 Development Cooperation Report were total commitments and not disbursements. The most significant change is the increase of assistance to the sector "General Development Issues, Policy and Planning" by $170.9 million or 204.4%. This, however, partly reflects that a major part of import support in 1987 has been included in this sector, while it was classified in 1986 in the "International Trade and Development Finance" sector. Specified import support, e.g. most import support directed to specific sectors, particularly to agriculture, industry and transport, have been reflected under these sectors. All priority sectors experienced major increases. Agriculture, industry and transport received additonal capital assistance of $45.3 million compared to 1986. The health sector received increased capital assistance of $25 million. However, part of this increase is caused by reallocation of water supply projects from the natural resources sector to the health sector and an increase in disbursement to water supply projects of some $11 million over 1986.

Bilateral donors are the main external contributors to the Tanzanian economy in terms of technical assistance. Bilateral T/A amounted to $226.4 million or 83% of total technical assistance. The bilateral donors contribution to T/A is illustrated by the following ranking:

Donor	Value ($ Million)	% of Total T/A
Sweden	57.3	24.4
Denmark	28.7	12.2
Finland	26.0	11.1
Norway	22.9	9.7
Total Nordic	134.9	57.4
FRG	18.0	6.8
Japan	15.6	6.6
Italy	13.7	5.4
Canada	13.0	5.4
The Netherlands	8.6	3.7
Switzerland	7.9	3.4

Source: Reference 4

For capital assistance, the following donors provide the largest assistance:

Donor	Capital Assistance ($ mill.)	% of total CA
World Bank	101.0	20.5
Sweden	51.3	10.4
The Netherlands	44.6	9.1
IMF	43.7	8.9
Norway	36.0	7.3
Japan	34.0	6.9
EEC	31.2	6.4
UK	29.0	5.9
Denmark	28.8	5.9
FRG	26.3	5.4
Italy	21.5	4.4

Source: Reference 4

Only four assistance programs are noted in international trade and development finance in 1987 -- two in technical assistance and two in capital assistance. These were:

- Export Training -- The Commonwealth Fund for Technical Cooperation committed a total of $91,000 for one export training advisor;

- Export Promotion -- The Swedish International Development Agency (SIDA) disbursed $158,000 in 1987 for assistance to the Board of External Trade in 1987, and planned disbursement for 1988 was reported as $473,000;

- Trade Promotion Program -- The EEC provided a grant of $328,000 over 1986-89 for assistance to/through the Board of External Trade; and

- Balance of Payments Support -- SIDA disbursed a total of $14.2 million in 1987.

While data on planned assistance for both capital and technical aid does not necessarily reflect future commitments, they give some indication of future trends. Some 52% of planned technical assistance is reported to be directed towards the priority sectors of agriculture, transport and industry. In the social sectors, employment seems to be a sector which will receive increased donor technical assistance. 87% of planned capital assistance is concentrated in agriculture, industry and transport.

F. References

1. USAID/Tanzania; Country Development Strategy: Tanzania: The Challenges of Recovery and Reform; Draft Report, March 31, 1989

2. Annual Budget Submission: Tanzania; FY 1989; May 1987; USAID

3. Annual Budget Submission: Tanzania; FY 1990; June 1988; USAID

4. Development Co-operation: Tanzania; 1987 Report; July 1988; UNDP

BACKGROUND INFORMATION ON MALAWI

A. Background

Malawi had an impressive record of economic growth up to 1979, with average annual GDP growth of some 6% over the first 15 years of independence, due mainly to an emphasis on agriculture at a time when most other sub-Saharan countries were stressing industrial development. Structural weaknesses had nevertheless begun to emerge by the mid-1970s, and these combined with adverse external factors to produce a recession from 1979 to 1982. On the external front, falling international prices for export commodities, soaring oil prices, and a gradual disruption of external transport routes through Mozambique led to a significant deterioration of the terms of trade. Droughs also reduced agricultural production.

The government's strategy for tackling the crisis rested on identification of six main factors impeding GDP growth:

- the slow growth of smallholder agricultural exports;

- lack of diversification in estate agricultural exports;

- the need to improve the management of public sector resources;

- the need to maintain and improve agricultural and industrial policies to cope with rapid expansion of the population and the labor force;

- the rising cost of energy resources; and,

- the increasing economic adjustment difficulties caused by the rigidities in the system of administered prices and wages.

The need for foreign exchange to back the restucturing effort and tide the economy over a sharp rise in debt service during the early 1980s (necessitating rescheduling in 1982-83) led the government into a series of negotiations with bilateral aid donors, the World Bank and the IMF. Relations with the Bank and the Fund have been relatively good, and the structural adjustment and financial programs agreed with them helped contribute to a strong economic recovery after 1983. Progress, however, was short lived as a combination of factors, including rising transportation costs and deterioration of export crop prices caused an adverse shift in terms of trade, put new strains on public finances, yielding a rapid rise in the fiscal deficit and a sharp reduction in credit to the private sector.

According to the World Bank, Malawi is now at a crossroads. The policy environment is likely to prolong stagnation and ultimately lead to even more serious problems. The government recognizes that it must renew its efforts towards structural reform and financial stabilization in order to create the conditions needed for sustained growth. In 1987 some steps were taken in this direction: private sector participation in smallholder agricultural marketing was officially encouraged, the kwacha was devalued 20%, interest rates were increased, and some actions were taken to increase budgetary revenue and contain expenditures.

The major development problems which USAID/Malawi has addressed thorough its program and project assistance can be categorized into four groups:

(1) Low per capita income due to low smallholder agriculture productivity and limited off-farm employment opportunities;

(2) High population growth rate, low child survival rates and overall poor health status;

(3) Insufficient technical, development planning, analytical and management capacities in both public and private sectors; and,

(4) Critical shortages of both foreign and domestic financial resources

To deal with these problems USAID financial assistance has risen significantly during the 1980s, from a total obligation of $5.6 million in 1980 to a high of $51.5 million in 1988. While some considerable annual variations have been seen in obligations, the annual average over the period 1985-89 has risen significantly over the average for the previous five year period, for all elements of the total assistance, as shown below:

Average Annual Obligation of Funds

	Period 1980-84	Period 1985-89
Total	$8.0 mil.	$31.8 mil.
Bilateral	$6.5 mil.	$19.2 mil.
Regional	$0.8 mil.	$ 5.8 mil.
Emergency	$0.7 mil.	$ 6.8 mil.

In the first of these two periods the following bilateral projects absorbed the bulk of the funding obligations:

- Polytechnic Engineering Expansion

- Agricultural Research

- Union of Savings and Coop Development

- Self-help rural water supply

- Management Assistance to rural traders

- Rural Development Linkages

A number of regional projects/programs received funding obligation during 1980-84. These projects/programs included:

- Amb. Special Self Help (1980-83)

- Regional Fisheries Development (1984-85)

- Program Development and Support I

- African Manpower Development I ((1971-81)

- Combatting Childhood Communicable Diseases (1982-87)

- African Manpower Development II (1982-87)

- Small Projects Assistance (1983-86)

During the period 1985-89, the following bilateral projects/programs were obligated or proposed:

- Health institutions development (1984-1989)

- Rural Enterprises and Agrobusiness Development Institutions (READI) (1984-1990)

- Malawi Agricultural Research and Extension (1985-92)

- Commercial Transport (1984-88)

- EPRP I: Fertilizer Subsidy Removal (1985-88)

- EPRP II: Parastatal Divestiture (1986-1989)

- Human Resources and Institutional Development (1987-95)

- Promoting Health Interventions for Child Survival (1988-94)

- Malawi Employment Generation Program (1988-1989)

- Program Development and Support (1988-96)

Among the various regional projects/programs, the following include the largest in this category during 1985-89:

- Northern Transport Corridor (1986-19)

- Regional Rail Systems Support (1988-92)

B. Current Status

In order to deal with the problem of low per capita income, USAID is supporting the GOM's efforts to stimulate agricultural growth and small and medium enterprise (SME) development. Various USAID activities in this area contain a stong entrepreneurship component and the Mission's overall project portfolio has a greater entrepreneurship than export orientation. However, all transportation projects/programs provide support for export oriented activities in Malawi.

Because agriculture dominates the Malawian economy, agricultural policy reform dialogue and a national research and extension program are the cornerstone of the USAID program (see section A above). These efforts, with parallel financing from the World Bank, are focused on intensifying traditional food production and encouraging diversification into new, higher value cash crops.

To expand the role of the private sector in Malawi's development and open up off-farm employment opportunitiies, the Rural Enerprises and Agribusiness Development Institutions (READI) project, implemented with assistance from Africare and CUNA, is helping strengthen and expand rural credit business advisory services. The Human Resources and Institutional Development (HRID) project and the proposed FY90 umbrella PVO program will fund future technical assistance and training, while the FY88 Malawi Employment Generation Program will generate local currency for industrial and commercial loans, as well as Small and medium size enterprises (SME) development support services. The foreign exchange resources from this sector assistance program will support the liberalization of the foreign exchange allocation system and the expansion of export industries. USAID's program complements the World Bank's policy dialog agenda and open project assistance from the EEC, UNDP and the Netherlands.

The problem of insufficient human resources and institutional capacity undercuts all the areas in which USAID is working, and export and entrepreneurship oriented activities clearly cannot flourish in an environment of weak human resources and institutional capacity. The Mission's strategy is to consolidate and simplify its programs to lessen the management burden it places on the Government and to work with other donors to do the same. Furthermore, the Mission initiated in 1987 the Human Resources and Institutional Development Project to be responsive to the government's requirements for technical assistance and training in those sectors critical to USAID/M's program strategy. While the project addresses six critical human resources and institutional constraints, it permits USAID and the GOM to focus and prioritize the project within these areas as needs change and development occurs over the eight year life of the project. The project places strong emphasis on the development of public and private sector management capability.

The Mission is helping redress the critical shortage of foreign and domestic financial resources through program and project assistance, as well as emergency food aid. Resolution of Malawi's severe transport problems is the GOM's top short-term priority. USAID is participating [illegible] multi-donor program to develop the Blantyre-Dar es Salaam route, or Northern Transport Corridor, which will provide a more reliable, less expensive route to Malawi's imports and exports.

USAID has made a significant contribution to expanding private sector involvement in the national econjomy. A major study conducted under the READI project on constraints and barriers to SME development served as the basis for the GOM's industrial sector strategy and its conclusions and recommendations have been incorporated into the government's Statement of Development Policy 1987-1996. Under the same project CUNA/WOCCU has helped establish a nationwide system of savings and credit cooperatives. Seventy one indigeneous-led societies are mobilizing rural savings and stimulating small business development. Increased savings have been generated and the value of such savings has been repeatedly demonstrated through the successes of new business enterprises that would not have otherwise existed, such as maize mills, poultry and hog farms, tailor shops, manufacture of roofing tile, mechanization of farm equipment and improved farm-to-market trucking facilities.

C. Future Plans

The four key development problems noted above will continue to guide and form the basis of USAID's development assistance to Malawi over the years ahead. However, the program is likely to be inceasingly influenced by two major factors. First, the growing number of refugees and regional instability will necessitate greater attention to food and emergency relief measures. Since the refugees are unlikely to be able to return to Mozambique in the near future, the Mission's assistance will have to deal with the adverse developmental problems associated with this large influx of additional people and how to minimize the resulting problems. This will undoubtedly mean further integration of the Mozambican refugees into the Malawian economy and conservation of land and natural resources in the areas affected.

Second, the government's economic austerity program over the next few years will result in a slow down in the pace of implementation of most development projects. This will require USAID to continue in the direction of greater reliance on nonproject assistance in which the foreign exchange can be disbursed rapidly to meet balance of payments needs while the local currency is focused on critical development activities, particularly in agriculture, health, human resources and employment generation--to lessen the potential negative consequences of structural adjustment and policy reform.

Finally, USAID's leadership and analytical role in policy dialogue will remain at the forefront of its development program. As demonstrated by its involvement to date in the fertilizer subsidy removal, parastatal divestiture and agricultural policy reform, USAID has a critical supportive role to play. Given the importance of agriculture, the private sector, employment and human resources to establishing a sustainable high level of economic growth, all these sectors will be areas in which USAID will concentrate its policy dialogue activities.

D. Indicative Requirements for Assistance

Indicative Requirement #1: Export Promotion Council Analysis/Assistance

Budget: $

Indicative Requirement #2: Malawi Enterprise Assistance Program Support Supplement

Budget: $

Indicative Requirement #3: Private Sector Issues Identification and Analysis

Budget: $

NOTES: The Mission Director did not think that a PSC at the mission was a strong requirement at this time; it depended on who they get for the 3rd PDO position; but the U.S. Embassy apparently does not want any larger U.S. contingent here.

It would be better to use more extensively the services of a central contractor in Harare, and regional knowledge and perspectives would be useful. The general contractor should preferably be able to handle substantive issues as well as being able to know how and where to access specific expertise. Expertise about capital markets would be especially important.

Dealing with trade policy would be new for them and would add another sector, and so is not wise at this time. Rather, studies in the trade area could deal with trade strategies and look at how SMEs could be moved from a domestic orientation to external orientation over time.

Program assistance could be considered in the form of adding a 4th year to the MED program, at which time they would know more and be able to specify additional/new conditionality. This could, for example, be aimed at removing obstacles to trade for SMEs.

Another thing that could be looked at in a regional framework is transportation policies, e.g. an extensic of the efficiency study of regional transportation that is now being conducted.

E. Other Donor Activities

Total development assistance to Malawi has increased significantly in recent years, more than doubling since 1985. These developments and the categorization of aid can be seen in Table 1.

Table 1
Trends in Development Assistance by type, 1983-87
(millions of US dollars)

Types of Assistance	1983	1984	1985	1986	1987
Technical Coop grants	34.7	39.7	34.9	44.8	45.4
Capital Projects	74.2	57.6	61.3	65.9	108.7
Program Aid	5.0	60.0	15.0	89.6	87.7
Humanitarian and Relief	-	-	0.2	1.0	3.1
Food Aid	2.9	1.2	1.6	1.6	10.4
Total ODA	116.8	158.5	113.0	202.9	255.3

Source: Reference 10

Bilateral donors -- led by the UK (25% of the total), the USA (14%) and the Federal Republic of Germany (11%) -- contributed the great bulk of T/A, amounting to $36.6 million in 1987, with UNDP supplying $4.7 million, The UN agencies other than UNDP providing $2.9 million, and other multilateral agencies funding the remaining $1.2 million. This distribution was similar in previous years.

The sector destination of the T/A reflects the sector and problem areas identified by USAID and discussed above. By far the two largest sectors were Agriculture, Forestry and Fishing (31% of total T/A) and Health (23%),

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followed by Industry (9%), Transportation (9%) and Education (8%). As in other countries in the SADCC region, International Trade and Development Finance received a very small share (1%). While direct and indirect support for export and entrepreneurship activities cannot be identified in the sector data, we know from the USAID projects that much of the aid allocated to the Agriculture, Industry, and Transportation sectors do in fact contribute to such export and entrepreneurship activities.

Capital assistance was committed and disbursed as shown in Table 2.

Table 2

Commitments and Disbursements on Capital Assistance projects active during 1987 by sector (in millions of dollars)

Sector	Committed as at 1/1/87		Disbursed in 1987	
General Planning	213.9		55.8	
Program Aid		204.4		55.3
Project Aid		9.5		0.5
Natural Resources	38.2		5.2	
Agriculture etc.	193.7		14.9	
Industry	57.0		23.9	
Transport etc.	252.0		28.6	
International trade	7.7		0.4	
Population	0		0	
Human Settlements	37.5		3.7	
Health	105.0		7.6	
Education	143.1		11.2	
Employment	0.9		0.0	
Social Services	1.8		0.4	
Culture	0.0		0.0	
Science	1.6		0.8	
Total (excl. program aid)	849.2		99.1	
Total (incl. program aid)	1053.7		153.3	

Source: Reference 10

Four donors dominate capital assistance: The World Bank (19% of the total), Japan (19%), the Federal Republic of Germany (15%) and the European Community (14%). Together these donors accounted for more than two thirds of total capital assistance, with the remaining share contributed by a number of bilateral and multilateral donors, led by the UK (7%), the African Development Bank (7%) and the US (4%). Compared to 1986, the importance of the World Bank has decreased and that of all other donors increased. In 1986 the World Bank disbursed a large bilaterally funded SAL III, and the major share of multilaterally funded SAL III assistance was disbursed in 1987. In 1988 the World Bank is again expected to become the single most important donor to Malawi. Approximately half of the capital assistance is in the form of soft loans from IDA, ADA and Japan. The other half comes from the EC and bilateral donors in grant assistance.

In the "sector" designated "International trade and development finance" the UNDP report lists the following donor assistance projects:

- Export promotion funded with $54,000 for 1987 by FINNIDA;

- Development Banking and Finance funded with a total of $15,000 by India and Italy;

- A grant of $174,000 was provided by European Development Fund for supplying a General Manager ("long term expert" for two years) to INDEBANK;

- A grant of $556,000 was provided by the European Development Fund for providing a General Manager ("long term expert for 5 years) to Malawi Development Corporation;

- A grant of $26,000 was provided by the European Development Fund for a training program for exporters; and

- The UNDP/ITC provided a grant of $1.13 million for consultants and the National Project Director for Malawi's Export Promotion Council.

G. Reference Documents

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3. Malawi/USAID; Recommendations of the SME Study Team that went to Kenya and Botswana (no date)

4. Malawi/USAID; Proposal to set up an SME Promotion Programme: Issues Paper (no date)

5. Malawi/USAID; Rural Enterprises and Agrobusiness Development Institutions (READI) Project: Rural Agro-business Pilot Promotion Sub-Project Report; March 1989

6. Malawi/USAID; Mission Strategy Matrix; August 1988

7. Malawi/USAID; Malawi Enterprise Development Program (MED); PAAD; August 1988

8. An Evaluation of the Malawi Rural Enterprise and Agrobusiness Development Institutions (READI) Project; Assistance to Resource Institutions for Enterprise Support (ARIES); September 1988

9. Malawi: Country Profile (1988-89); The Economist Intelligence Unit

10. UNDP; Development Cooperation: Malawi--1987 report; July 1988

BACKGROUND INFORMATION ON ZAMBIA

A. Background

Zambia's overall economic situation continues to be grim. The economy is suffering from the combined effects of a prolonged period of misaligned economic policies, a long-term decline in the price of copper, declining copper production and reserves, and a very heavy external debt burden. The combined effects of these problems has been a long, steady and significant decline in real per capita GDP in real terms.

Although recognizing the problem earlier, the government seriously began a process of economic reform and stabilization with the support of the IMF and the Western donor community only in 1982. Since that time, but especially over the period from October 1985 to December 1986, the government took significant steps of announcing and at least partially implementing what was seen by some as the most wide-ranging economic reform effort in Sub-Saharan Africa. If implemented, this reform program will lay the basis for the restructuring of Zambia's economy and the lessening of the country's dependence on the extractive sector, especially copper. Beginning in mid-December 1986, however, the government has significantly slowed the pace of reform and, in May 1987, with its decision to break with the IMF, the government announced that it would be introducing a new "self help" recovery program for the economy, focused on mobilising domestic resources. In addition, the government at least temporarily reversed several of its previous reform measures.

Although the government was still insisting in September 1988 that the "go it alone" policy was succeeding, all indications are that the interim plan, the INDP, is not nearly meeting its goals. In mid-1988, the government began an assessment of the INDP, with support from the Nordic countries and the Netherlands, and with a view to making revisions for inclusion in the fourth five year plan, due in 1989. In the latter part of 1988, Dr. Kaunda stated that price controls are likely to be removed and that reducing government spending and the budget deficit is a priority. He also hinted at greater private sector involvement in the parastatals and the turning of a number of government departments : private companies. Readjustments to exchange rate and debt management policies have also been under consideration.

The combination of externally and internally driven factors undermining the performance of the Zambian economy in the 1980s have resulted in serious problems of declining real per capita income and inadequate job creation. These twin problems have formed the basis for USAID's assistance strategy for most of the 1980s. Based upon these problems and supporing analysis, the Mission's primary strategy objectives were to (1) increase food production, and (2) increase small farm productivity and income. In addition to these two primary objectives, two supporting goals were also identified. These were to (3) increase incomes in non-farm rural enterprises, and (4) reduce the rate of population growth.

The Mission's emphasis on the agricultural sector was supported by the analysis and conclusions contained in various documents of the IBRD and the government of Zambia. The modalities through which these goals have been pursued are: (1) policy dialogue and (2) institution and human resource development, particularly in planning and policy analysis and information gathering, analysis and dissemination, agricultural research and extension and training. While these activities have had little if any export orientation, many of the programs and projects have supported entrepreneurship, particularly in rural areas.

B. Current Status

The current program and project portfolio of USAID strongly reflects both the continuing serious macroeconomic problems which the country faces and the Mission's continued and dual focus on increased food production, agricultural products marketing and increased small farmer income, with emphasis placed on policy reform. Assistance has also been provided through institutional and human resource development and technology generation and dissemination of technology information.

However, changes in the government of Zambia's policy matrix over the last few years have had a wide ranging impact on USAID's current program. These policy changes and the resulting uncertainty, as well as the additional constraint of having to operate under the Brooks Amendment, have also impacted new program and project design efforts and required some re-design. The Mission has therefore been operating with a bridging strategy between the last CDSS strategy and the anticipated strategy to be presented in the FY1990 CDSS.

A review of the Mission's Annual Budget Submissions reveals project/program portfolios which reflect the goals stated above as well as the strong emphasis on the agricultural sector. Some of the major projects/programs include the following:

- Commodity Import Programs (CIPs);
- Agricultural Training, Planning and Institutional Development (ZATPID);
- Agricultural Development: Research and Extension (ZAMARE);
- Human and Institutional Resources Development (HIRD);
- Zambia Multi-Channel Agricultural Marketing Program (ZAMCAM);
- Zambia Auction Program Support (ZAPS); and
- Zambia Regional Transport and Storage Development.

The commodities imported through the CIPs and ZAMCAM have been directed towards constraints in the agricultural sector, i.e. agricultural inputs for the production subsector (fertilizer, and machinery and spares), transportation equipment (trucks, spares, tires, lubricants) and agricultural processing equipment and machinery for the marketing subsector.

One of the major projects launched by the Mission in recent years is the Zambia Agribusiness and Management Support (ZAMS) project. A basic rationale for the ZAMS Project is that it could serve as an effective vehicle to help move the economy from the inherited system based largely on marketing through parastatals, towards a system in which private enterprise takes on increased marketing functions. Another is that, in general, agricultural production technology in Zambia is ahead of agricultural marketing practices. Unless constraints in marketing facilities, practices, and processes are mitigated, further achievements in productivity would be difficult to obtain.

The strategy of the ZAMS project is to focus on those elements in the private sector agricultural marketing system that will help the government of Zambia to achieve key objectives that were outlined in the Interim National Development Plan (INDP) fulfilling the policy of "growth from our own resources". The main goal in the INDP's marketing, transport, and storage program is to create and maintain the conditions which will ensure an increase in the operational efficiency in the marketing of agricultural inputs and outputs.

Although the initial project design had a considerable export orientation, this was modified towards an almost exlusively domestic focus because of the overvalued exchange rate and the problems this would create for an export strategy. The major elements of the project include: (a) technical assistance, (b) training, and (c) commodity imports.

C. Future Plans

Based on the work the Mission has done to prepare a long term CDSS strategy, it anticipates that the key development problems to be addressed in FY1990-FY1994 will remain substantially the same:

- Inadequate income growth, with its concomitant problems of unemployment and underemployment; financial instability and structural weakness; and

- Complicating population pressures.

It is expected that the overall objectives of the Mission's program of assistance for the first part of the 1990's will be to increase productive employment and real per capita income of small-scale farmers and other rural inhabitants. The Mission will attempt to do this by seeking ways to support:

(1) Increased and more diversified production (especially for export) and real income from both (a) small farms, and (b) small scale rural and agri-business enterprises; and

(2) A long term reduction in the rate of population growth

In pursuit of these objectives, the Mission will seek ways to help the government of Zambia support small-scale agricultural development and diversification and rural and agriculture-related small scale enterprise development by:

- Creating a more favorable policy environment;

- Improving marketing arrangements and supporting institutions; and

- Improving necessary physical infrastructure

The principal differences between the approved long term strategy and that anticipated for FY1990-FY1994 are: (1) a movement away from a concentration on food production into a process of agricultural diversification and exports; and (2) an inceased emphasis on small scale enterprise development as an additional means to increase incomes in rural areas.

The shift away from a concentration on food production and towards agricultural diversification and exports is primarily due to the success of the government in adopting policies which are providing more adequate incentives for food production, as well as the development and adaptation of a variety of technological packages appropriate for small farm use. As a result, Zambia is now largely able to feed itself without recourse to imports of its staple commodity, maize, except in periods of adverse climatic conditions. The process of promoting agricultural diversification and exports is the next logical step in the development of Zambia's agricultural potential which is also its area of continuing comparative advantage.

While USAID's programs and projects have therefore not had much export orientation, although more has been done to stimulate and encourage private sector entrepreneurship, especially in rural agriculture, it is likely that greater emphasis will be seen on export orientation in the next few years.

D. Indicative Requirements for Assistance

Indicative Requirement #1: Technical assistance for Zambia's Agribusiness & Management Support Project (ZAMS)--Third Year Supplement

Budget: $

Indicative Requiremetn #2: Extend IESC Services under ZAMS to include Private Export Producers

Budget: $

E. Other Donor Activities

External assistance to Zambia increased rapidly during the seventies and early eighties, peaking in 1984 at $632.9 million. Total Development Assistance (TDA) subsequently decreased and reached $415.9 million in 1987, a decline of 26% since 1986. The change in TDA is mainly caused by fluctuations in Capital Assistance. There has been an increase in Technical Assistance from 1984 onwards, exceeding capital assistance for the first time in 1987, and has increased by 57% over 1986. Commodity Assistance has increased by 51% to $64.2 million.

The sectoral distribution of technical assistance shows the bulk of assistance going to two sectors: Agriculture, Forestry, and Fisheries (33.8%) and Education (26.7%). Activities supported in the first of these sectors include agricultural cooperatives -- primarily supported by the Nordic countries -- research and training of personnel, and the establishment of productive units and improving the supply of materials. The Natural Resources sector received 12.6% of total technical assistance, while the Transport and Communciations sector. and General Development Issues, Policy and Planning received 8.7% and 7.6%, respectively.

The distribution of capital assistance was targeted primarily at the industrial sector, which received 37.7% of all capital assistance, where two major projects -- one being an IBRD project investing $29.9 million in ZCCM and the second an EEC project to rehabilitate the copper mines. The other major recipients of capital assistance were International Trade and Development Finance (19.3%), where most of the assistance was in the form of balance of payments and import support, Natural Resources (14.0%), where the bulk of the funds went to improvement of rural and urban water supply, Agriculture, Forestry and Fisheries (12.5%), and Transport and Communications. In the last sector most of the assistance for the sector went to road construction and rehabilitation (70.8%) and supply of equipment and spare parts (27.1%).

The largest donors for technical assistance were as follows: The UK ($47.5 mil), Italy ($25.0 mil.), Sweden/SIDA ($16.6 mil.), Finland ($12.8 mil), Norway/NORAD ($12.4 mil), and USA/USAID ($9.8 mil). For capital assistance the leading donors were: IBRD ($33.6 mil), Federal Republic of Germany ($19.5 mil), IDA ($17.0 mil), The Netherlands ($15.0 mil) followed by Italy, Japan and Finland.

According to USAID/Zambia, the Export Board and the government of Zambia, was during the Spring of 1989 in the process of signing an agreement for a regional NORAD/SIDA-funded export revolving fund. Zambia's portion of that fund would tentatively by $250,000.

According to other Mission sources "other-donor" activities in agricultural marketing that are related to export or entrepreneurship can be noted. Two particularly active donor groups are the UNDP and the World Bank. Two of the UNDP's 3 projects relating to agriculture marketing also are trade related. One provides assistance to the Export Board of Zambia to enhance its marketing services for a range of commodities, including agricultural products (the project involving T/A for 60 months). The second project is a regional export promotion project being implemented with the Preferential Trade Association (PTA). It uses a computerized network, in which PTA registers companies within the region which wish either to export their products or to import supplies, equipment, or raw material, and provides the information on request to would-be importers and exporters. PTA expected by mid-1988 to have tied into Reuters international market news service as an additional service to members.

While World Bank projects were reportedly suspended pending Zambia's payment of loan arrears, a planned World Bank supported, planned project would provide financing for a cool-room at the Lusaka International Airport, to facilitate exports of fresh fruit and vegetables. (Note that interviews by the Harare project design in Lusaka also confirmed that lacking or poor airfreight possibilities prevented significant exports of agricultural products to Europe, for example). This World Bank project would also provide substantial support to both the Export Board of Zambia and the Zambia Export Growers' Association.

F. Reference Documents

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BACKGROUND INFORMATION ON ZIMBABWE

A. Background

A number of characteristics set the economy of Zimbabwe apart from most of the other SADCC countries and give it a stronger basis on which to build exports and entrepreneurship. Among its strengths are: a well developed infrastructure; a well balanced distribution of economic output among the industrial, agricultural and mining sectors; and, significant international trade activity--representing 47% of GDP (and dominating intra-SADCC trade with about three-fourths of the total).

The government has taken various measures to increase exports, although often these measures have been inadequate to compensate for existing obstacles, many of which are results of government policy. Export promotion measures taken include:

- The introduction of an export incentive scheme;
- The export revolving fund, which facilitates the availability of foreign exchange for those producing for exports; and
- An export bonus scheme, whereby exporters get a supplementary foreign exchange allocation based on their exports, for use in production for the domestic market.

Also, the government has activated a number of international loans earmarked for export promotion purposes.

These favorable features of the economy and the positive export promotion measures taken must be seen in the context of offsetting economic weakenesses and difficulties facing exporters and entrepreneurs in Zimbabwe. Lack of foreign exchange and efficient and economical transportation for exporters remain serious constraints on exporters in Zimbabwe, as in most of the other SADCC countries. These constraints have shaped much of USAID and other donors activities in Zimbabwe and in the region.

Excessive controls and regulatic ı private sector activities has long stifled entrepreneurial initiatives and discouraged both domestic and foreign investment. Government participation in industry also tends to undermine the role of the private sector, illustrated by the role and activities of the Industrial Development Corporation (IDC). In a recent example, government demands for a significant equity share for IDA in a multi-million dollar project for the local manufacture of metallic cables by a UK-based multinational firm, caused long delays in the project and resulted in lost export earnings and reduced foreign exchange payments from import substitution.

A World Bank classification of the countries in southern Africa according to trade restrictions further illustrates the challenges which Zimbabwean exporters and entrepreneurs face. Among the 35 countries evaluated, Zimbabwe was placed in the "very restricted" category, in the company of Zaire, Uganda, Sudan, Somalia, Rwanda, Kenya and Ethiopia.

A wide range of economic policies are currently under examination by the government to induce greater domestic and foreign investment. The most important issues being looked at include:

- The present foreign exchange system and the possible effects of phased trade liberalization;
- The balance of payments strategy, including debt-management policy;
- The budget deficit and its effects on economic growth;
- Price controls and possible limits to the number of products affected; and
- Investment policy and priorities

The long awaited investment code was recently published and may promise to make Zimbabwe more attractive to foreign investment. The one-stop investment center could significantly reduce bureaucratic delays which have long deterred investors. Effective implementation and observance of the 90 day limit for responding to project proposals would represent a positive signal to both domestic and foreign investors.

Both the bilateral and regional USAID programs in Zimbabwe have contributed to the development objectives of the SADCC region as a whole and those of the government of Zimbabwe. These objectives have included:

- Strengthening rail, road, and port facilities to provide more efficient and cost effective alternatives to South African routes;
- Promoting agricultural productivity and providing regional food security; and
- Developing the region's human resource base and management effectiveness in the transportation and agriculture sectors.

By the end of the decade of the 1980s, AID will have provided over $170 million to improve capacity and efficiency in the region's rail and road networks. Seven AID-funded transportation projects will be in implementation with promising prospects for improving the capacity and operational efficiency on major transport corridors. This promises to yield signficant benefits for exporters in Zimbabwe and other DADCC countries.

According to the Annual Budget Submissions and the CDSS, the assistance provided by USAID/Zimbabwe has aimed at solving the major problems constraining the expansion of wage employment. In this context, programs and projects funded have aimed to: (1) increase both off-farm and on-farm income earning opportunities, (2) invest in development of more skilled human capital, and (3) reduce, over time, the population growth rate and the number of new entrants into the labor force. Major programs supporting these objectives have included:

- The Basic Education and Skills Training Sector Assistance Program (BEST);
- The Zimbabwe Agricultural Sector Assistance Program (ZASA);
- The Zimbabwe Manpower Development Program (ZIMMAN); and
- The Child Spacing and Fertility Project (CSFA)

Through many of these projects, and by moving foreign exchange to priva sector importers through a private sector commodity import program, USAID ha helped strengthen the private sector. Between 1982 and 1986 USAID provided nearly $160 million in commodity import assistance designed to increase foreign exchange availability for the importation of equipment, spare parts and raw materials. These inputs were required to increase capacity utilization in Zimbabwe's industrial sector and thus generate employment. Nearly 90% of this program's assistance went to the private sector.

Entrepreneurship has been supported through USAID's help in launching t Small Enterprises Development Corporation (SEDCO). A planned project target the establishment of the Zimbabwe Export Promotion Cooperative (ZEPCO) for assistance to exporters, but this project has not been realized..

B. Current Status

The current project porfolio of USAID and the Southern Africa Regional office reflect the objectives stated above. Among the projects in the portfolio of the bilateral USAID program, project assistance activities in FY 1989 include: (1) Zimbabwe Agricultural Sector Assistance; (2) Basic Education; (3) Zimbabwe Manpower Development Program; and (4) Zimbabwe Manpower Development Program II.

C. Future Plans

According to the FY1991 Regional Development Strategy Statement for Southern Africa the strategy for the period 1991-1995 evolves from the strategy for the period of the late 1980s. It will continue a concentrated effort to promote improved transport infrastructure but will give attention matters of efficiency in operations and financial management issues of costs and competitiveness. The strategy will respond to the strengths of the SADC Secretariat in Gabarone and the sector units concerned with transport and communications and with food security. It will also seek to maintain moment in agricultural research and, finally, will promote steps to stimulate priva sector trade and entrepreneurship that are necessary to economic growth.

In the future additional assistance from USAID/Zimbabwe will likely be targeted at assisting the private sector and for protecting and conserving the wildlife in the region. Private sector support programs will continue to provide foreign exchange for much needed commodity imports as well as providing various forms of technical assistance to enterprises. Finally, the Mission will likely fund studies and expert consultations in such areas as investment promotion, the viability of parastatals, the benefits of privatization, the foreign exchange allocation system, and specific areas within the tax structure.

D. Indicative Requirements and Potential areas of Assistance

Indicative Requirement #1: Policy Formulation Assistance to the government of Zimbabwe

Budget:

a. Short Term T.A.	$200,000/yr.

Indicative Requirement #2: Support to Zimbabwe Export Promotion Program or to its successor (Zimbabwe International Trade Organization)

Budget:

a. Long Term T.A. @ $125,000/yr.		$125,000
B. Short Term T.A. @ $14,000/mo.	15 mos.	$210,000

NOTE: ZEPP is scheduled to be phased out in September, 1990, to be replaced by the private sector Zimbabwe International Trade Organization. This organization will have an 8 member board--four appointed by the private sector and four by the public sector. ZEPP, which is funded by the EEC, has the following four primary activity areas:

- Export Promotion to Southern Africa (except RSA);

- Export Promotion for the following six sectors: (1) Clothing; (2) Textiles; (3) Leather; (4) Furniture; (5) Processed Foods; and (6) Horticulture. These products are targeted primarily at markets in developed countries, specifically Europe;

- Human Resource Development/Training. ZEPP has completed 30-40 training programs over the last 18 months (run by domestic and foreign consultant organizations); and

- Institutional Development. They have established a one-stop export promotion unit which is scheduled to take over the job of various other agencies. The broad outline of this unit has been agreed to and working group has been formed for final implementation.

E. Other Donor Activities

Although the U.S. was the first to provide economic assistance to the new nation of Zimbabwe with a grant of $2 million on independence day, large scale economic assistance to Zimbabwe effectively began with the commitments made at the Zimbabwe Conference on Reconstruction and Development (ZIMCORD) in March 1981. At this conference, attended by some eighty delegations, external assistance pledges topped Z$2 billion and were almost equally divided between grants and loans. Most funds were earmarked for the government's Public Sector Investment Program (PSIP).

Donor Assistance, AID's included, during the first two years of independence was heavily focused on the reconstruction and rehabilitation of the country's infrastructure -- schools, clinics, hospitals, roads, bridges etc. -- destroyed or damanged during the war. The focus of donor assistance began shifting in 1982/83 to the longer term development concerns and many donors started committing resources to also help with drought relief. The government successfully appealed to donors during the three years (1982-84) of economic recession, to convert some funds lready earmarked for project aid to commodity imports, cash transfers, and other forms of quick dispersing program assistance. This was needed to provide sorely needed foreign exchange for food and essential raw material imports. Moreover, many donors were open to commodity import programs following the successful model set by AID.

For 1987, the latest available data for comprehensive donor assistance data, the distribution of assistance to Zimbabwe was as seen in the table on the next page. As discussed previously for other SADCC countries, the allocation of only 1% of total aid to international trade related activities underestimates the total funding for such activities, a significant share of whose funding is allocated to various other sector.

Table 1
Summary of total assistance by sector, 1987
(US$ millions)

Sector	Technical Assist.	Capital Assist.	Commodity Assist.	Total Assist.	Percent
Political Affairs	0.2			0.2	*
General Development	16.2	12.3	0.04	28.5	24%
Natural Resource	3.6	4.6		8.2	7%
Agric., Forest. & Fish.	11.4	19.0	5.5	36.0	30%
Industry	0.7	6.6		7.3	6%
Transport & Communic.	2.5	0.8		3.3	3%
International Trade	0.7	0.7		1.4	1%
Population	0.4	0.1	0.6	1.1	1%
Human Settlements	0.9			0.9	1%
Health	7.9	5.3		13.2	11%
Education	8.5	6.3		14.9	12%
Employment	0.3	*		0.3	*
Humanitarian Aid & Relief	0.8	0.2	3.9	4.9	4%
Science and Technology	0.2	0.9		1.1	1%
Total	54.4	57.0	10.0	121.4	100%
Percentage	45%	47%	8%	100%	

Bilateral sources accounted for 78% of the total value of technical assistance activities reported in 1987, or similarly to 1986. The assistance was directed mainly towards General Development, Agriculture, Health and Education and the main bilateral donors were the U.S., Italy, Sweden and the UK.

The UNDP provided about 1/3 of total technical assistance to the international trade sector, with other UN or other multilateral agencies providing the rest. UN or other multilateral agencies also provided all of the capital assistance to this sector.

During 1986 and 1987 the following international trade assistance activities were reported:

1986:

- Beef Export Study -- funded by the EEC, analyzing the export potential in Western Europe (total commitment of $53,000);

- Trade Promotion: Trade Information Services for Export -- provided by ITC/Italy Trust Fund (total commitment of $253,500);

- Technical Assistance in Trade Promotion -- provided to ZEPP by the EEC for training in Trade Promotion (total commitment of $274,000);

- Trade Fair Consultant -- provided by the Federal Republic of Germany (total commitment of $430,000);

- Assistance to Zimbabwe Export Trade Promotion Council--provided by the U.S. for an export trade study (total commitment of $44,000);

1987:

- Zimbabwe Export Development Program -- provided by the EEC to the Ministry of Trade and Commerce (total funds disbursed in 1987: $327,000);

- Trade Promotion -- funded by the EEC for the period 1986-90 to the Ministry of Trade and Commerce and the Confederation of Zimbabwe Industries (total commitment of $1.033 million);

- Commercial Representation -- provided by the Federal Republic of Germany for workshops (total commitment of $98,000); and

- Trade Development -- provided by the UNDP for preparatory assistance in trade development strategies and programs for the Ministry of Trade and Commerce (total commitment of $21,000).

The World Bank's lending to Zimbabwe has also had signficant impact on the country's international trade. The first generation of World Bank programs provided funds for imports, while the second generation efforts provided a fuller packet of services targeting areas that included market development, technical assistance in marketing, financial planning, and product design. It also contained a component of institution building, for example working with the export-import bank.

No new World Bank package is yet ready for Zimbabwe but next fiscal year, it is likely that it will provide a large package that could reach $2-300 million over 18 months. This arrangement is expected to contain a structural adjustment facility and perhaps a sectoral component and will likely address balance of payment and investment issues.

F. Reference Documents

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2. Zimbabwe: Success at Risk; The Economist; April 22, 1989
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7. Report on Development Cooperation 1986; UNDP--Zimbabwe
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9. Intra-regional Trade in Sub-Saharan Africa; World Bank; March, 1989
10. Financial Gazette (Zimbabwe); various issues

Export Enterprise Support (EES) Project

Annex D:

Selection of Project Components

I. Criteria for Selection of Project Activities:

Project activities to be included must be <u>project assistance</u> which:

1) Are consistent with the SADCC Trade and Industry Sector Strategy and are supported by the respective host country Government.

2) Contribute to export expansion in the private sector

3) Possess the potential for application in a multi-country/regional context

4) Are conducive to economies of scale in service delivery

5) Have proven historical basis or reasonable conceptual basis for effectiveness in achieving desired results

6) Does not place excessive administrative burdens on AID Missions

AND

7) Promotes public and private sector dialogue within SADCC countries, or in SADCC as a region (including through the SADCC Business Councils)

OR

8) Serves businesses by:

a) at the firm level providing technical services to private exporters

OR

b) at the national level strengthening business and public sector organizations serving exporters

II. Regional Activities

II.A. Strengthening Business Organizations

1) Start-up Institutional Support to the SADCC Regional Business

Council Secretariat

The purpose is to encourage the new SADCC Business Council concept to make a transition towards effective implementation. This will support policy analysis and dialogue focused on issues of export promotion.

> 3 years funding at 250,000 per year for office expenses, initial support for an executive secretary.

2) Start-up Institutional Support to the SADCC National Business Councils in Member Countries

The purpose is to provide one-time start-up grants to the host institutions in each SADCC country designated as the administrative implementor of the National Business Council. This would provide for equipment to enhance communication with members and the Regional Business Council Secretariat

> first year funding of 50,000 to each of the 8 National Business Councils

3) Regional Conferences of Business Organizations

The purpose is to encourage stronger business organizations in the region by holding yearly conferences which would enhance information sharing and present models of how successful business organizations serve their members. Seminars, case studies, and workshops on aspects of effective administration of business organization operations would build a network of contacts, identify areas for possible future assistance, and encourage private sector business organizations. This would contribute to a stronger voice for the private sector which can assist in policy analysis and dialogue concerning export promotion. Planning would be done in association with regional business organizations, including the SADCC Business Council structure; operation of the actual seminars would be done with technical assistance.

> **3 years of funding for 1 conference per year; to include 3 months of short term technical assistance for pre and post support and 150,000 in expenses**

II.B. Policy Analysis, Dialogue and Reform Assistance

1) Analytical Support to Dar Sector Unit for Developing a Trade and Industry Program of Action

The purpose in the first year would be to help Dar convert the new Industry and Trade Strategy into specific activities in the Program of Action. In subsequent years the support would help prepare options for revising and extending the Program of

Action.

3 years of short term technical assistance at 3 months per year

2) Studies Support for the Dar Unit to Investigate Export Issues

The purpose is to provide the Dar unit with funds which can be used to explore issues and develop options related to export promotion. The standard conditions AID places on studies support to SADCC would apply.

3 years of support at 50,000 of studies work per year

3) Regional Conferences of Government Export Administration Officials

The purpose would be to focus regional officials on common elements of export promotion and present options for more productive approaches. A yearly conference would bring these officials together to strengthen their network, expose them to alternative service approaches in the region, and highlight the most productive export promotion programs from around the world. Workshops, seminars and case studies would provide encouragement for alternative, less administratively restrictive organizations. The planning for the conferences would be done in association with the Dar Unit, which could be a co-sponsor; the Business Councils should also be involved in planning the agendas to focus on critical constraints for exporters emanating from government export promotion functions.

3 years of support for 1 conference each year; short-term technical assistance to be provided for 3 months of pre and post conference assistance as well as a start-up 3 month period of needs assessment and initial design. Expenses of the Conference and partial support for regional officials to attend at 200,000 per year.

4) Harare Export Enterprise Support Project Office Studies For Phase 2 Development

The purpose is to assist SARP in planning for a Phase II of the project. It would allow the Project Office to initiate studies and analysis of issues designated by SARP as fundamental to assessing the regional condition of export activity and options for future assistance.

3 years of studies effort at 10 months of short term technical assistance per year.

II.C. Promotional Information and Service Assistance

1) Regional Promotion/Information Activity In Regional Office

The purpose is to provide a pro-active regional advisor whose area of responsibility would be promotion of the region's exports through a broad array of services and activities. The advisor would be knowledgeable of regional exports and business opportunities, foreign investors, sources of finance, sources of project development support, sources of management talent, risk reduction mechanism, etc. This advisor would backstop the regional Missions and any requests for assistance to individual exporters or export organizations. The position would also be responsible for maintaining current information to support promotion of the region, which would support investment missions and conferences. Assistance in pre and post OPIC type mission planning and support would also be included. Other functions would include maintenance of an inventory of information on regional export issues and initiatives (by governments, organizations and donors) as well as liaison with other donors and export/investment promotion organizations in the region and elsewhere.

3 years of long term technical assistance for this regional promotion/information activity as part of the services to be delivered by the Regional Project Office. Such service could be physically separate from the Project Office and might be provided by a regional consulting group or other regional expert.

2) Regional Sector Seminars

The purpose would be to bring together producers of selected products with existing or potential competitive advantage in the export sector. This would support strengthened contacts between producers of a product line, expose common issues and problems, and present world experts on key areas of the product production and marketing. Such seminars would also identify areas of needed assistance and potential for expanding local-regional sourcing of inputs and economies of joint procurement. Follow-up visits to plants by technical experts could provide economies of service delivery in addressing specific problems in a product sector. Planning would include advice on priority of sectors to be covered by business organizations in the region through SADCC Business Council structure; business organizations would be co-sponsors. This activity could be attached to either the Dar Sector Unit or the Regional Business Council as a regional host agency.

6 seminars over 3 years; 3 months of short term technical assistance per conference plus expenses of 100,000 per conference.

3) Rotating Training Courses for Exporters

The purpose would be to provide short-courses on selected aspects of export activity by producers. These courses would move sequentially throughout the region to provide access to the information in a cost-effective way. Planning for the types of short-courses required and co-sponsorship would come from the involvement of regional business organizations. This activity could be attached to either the Dar Sector Unit or the Regional Business Council as a regional host agency.

> 4 short-courses per year for 3 years, each short-course moving to 4 locations in the region; each short-course requiring 2 months of short-term technical assistance and 25,000 of expenses.

4) OPIC Type Missions to the Region

The purpose would be to provide aggressive support to a series of OPIC type missions to expose foreign investors to the region and potential joint-venture type activities. Working in association with OPIC or other appropriate organizations, this activity would provide sound pre and post preparation/follow-up. It would provide a regional dimension to the missions, leaving to the investors and firms in the region the responsibility for further analysis and implementation. Identified opportunities, with assistance from the post-mission follow-up support, could then draw upon technical assistance for feasibility studies and other types of assistance. Planning and participation during the Missions would involve regional business organizations, which would also be co-sponsors.

> 2 missions per year for 3 years, including pre and post mission preparation/follow-up. 3 months of short-term technical assistance per mission and 50,000 of expenses.

5) Export Marketing Degree Program Rotating Seminars

The purpose would be to address an identified need for managerial training in export activity in a cost-effective manner. Use of a U.S. business school to provide seminars and case studies would be part of the central project's activities. The "weekend" seminars would rotate to several locations in the region on a monthly basis for 9 months each year. Participants would partially or fully pay for costs of participation in local currency. An appropriate degree or certificate would be awarded to those completing the course sequence.

> 3 years of degree program activity at 1 year of long-term technical assistance per year and 250,000 of expenses each year.

II. D. Activities Excluded

1) SADCC Region Investment Deal Maker

The purpose would be to aggressively seek out regional opportunities for investment in export related enterprises and find foreign joint partners or investment support. An incentive contract would reward the "deal maker" according to the number and volume of matches produced.

> Reason for Exclusion: Experience elsewhere shows that incentive based arrangements for deal makers have not been effective; based upon the criterion that project activities must have potential to address the problems at hand, this proposed project activity does not qualify to be included in the project.

2) SADCC Region Representation Office in New York

The purpose would be to provide a visible presence for the region in a major international financial center. Economies of scale in service delivery would be feasible; individual exporters and organizations in the region could use the office and support facilities of the Center. A commercial firm with expertise in trade representation would provide back-stopping support for activities in the region, including assistance in the OPIC missions, provision of information to interested parties (including commercial attaches of member countries) and other help. A pro-active representative in the New York Center would promote the region, including information and encouragement of potential investors and traders.

> Reason for Exclusion: Experience elsewhere shows that while there is need for countries to have a visible presence in major financial centers, it is not cost-effective to use commercial services to perform such activities.

III. National Activities

> **(for descriptions of project elements and information on budget levels, see the Annex Background Information for the respective Countries)**

III.A. Strengthening Business Organizations

Lesotho

1) Small Business Development Center in LCCI

Mozambique

1) Support for AEPRIMO, Private Sector Business Association

Swaziland

1) Public/Private Policy Dialogue and Market Forces Encouragement

III.B. Policy Analysis, Dialogue and Reform Assistance

Botswana

1) Export Promotion Policy Dialogue and Strategy Development
2) Government of Botswana Export Promotion Institution Building

Lesotho

1) Trade Promotion Unit Support
2) Policy Formulation Assistance

Malawi

1) Export Promotion Council Analysis/Assistance

Mozambique

1) Support for GPIE, the Office for Foreign Investment Promotion
2) Support for National Directorate for Foreign Trade Operations
3) Export Processing Zone Development Feasibility/Design Assistance

Swaziland

1) Investment and Trade Relations Project with Government of Swaziland

Tanzania

1) Policy Formulation Assistance

Zimbabwe

1) Policy Formulation Assistance

III.C. Promotional Information and Assistance

Botswana

1) Foreign Joint and Co-Ventures Assistance
2) Participation in Regional Trade Initiatives
3) Product/Market Development for High-Growth Potential and Labor Intensive Businesses

4) Key Growth Interventions to Assist the Private Sector

Lesotho

1) Loan Portfolio Guarantee Assessment Assistance in LCCI
2) Pre-feasibility Studies for Large Businesses through LNDC and MT&I

Malawi

1) Private Sector Issues Identification and Analysis

Swaziland

1) Start-up and Growth of Export-Oriented Small Enterprises Assistance
2) Export Business Representation and Business Association Assistance
3) Foreign Co- and Joint Venture Development

Tanzania

1) Assistance to Export-Oriented Businesses

Zambia

1) Zambia Agribusiness & Management Support Project (ZAMS) Third Year Supplement for Technical Services to Exporters
2) Extend IESC Services Under ZAMS to include Private Export Producers

Zimbabwe

1) Support for Zimbabwe Export Promotion Program (ZEPP) Activities Integration into new Quasi-Private Zimbabwe International Trade Organization (ZITO)

III.D. In-Country Project Administration

Botswana

1) Export Promotion Advisor in AID Mission

Lesotho

1) Private Sector Officer in AID Mission

Swaziland

1) Trade and Entrepreneurship PSC in AID Mission

III.E. Activities Excluded

Botswana

1) Loan Guarantees for Citizen Entrepreneurs to Cover Export Finance

Reason for Exclusion: the activities are limited to project activities and exclude provision of credit.

Lesotho

1) Export Finance Scheme Capital Contribution

Reason for Exclusion: the activities are limited to project activities and exclude provision of credit.

Malawi

1) Malawi Enterprise Assistance Program Support Supplement

Reason for Exclusion: the activities are limited to project activities and exclude program assistance.

Mozambique

1) Support for Private Truck Leasing Firm

Reason for Exclusion: Security issues and tangential relation to expansion of exports makes the activity high risk and indirect.

Swaziland

1) Export-Oriented Revolving Credit Fund for Small and Micro Enterprises

Reason for Exclusion: the activities are limited to project activities and exclude provision of credit.

2) Access to Sites and Services for Small and Micro Exporters

Reason for Exclusion: the activities are limited to project activities and exclude provision of capital construction.

Export Enterprise Support (EES) Project

Annex E:

U.S. A.I.D. Policy Towards Trade and Entrepreneurship

General A.I.D. Development Strategy

The strategic plan guiding A.I.D.'s activities and funding is described in a 1984 Blueprint for Development.[1] This selects four basic programmatic components of the approach to development assistance:

- -policy dialogue
- -institutional development and training
- -technology: research, development and transfer
- -reliance on the private sector and market forces

These are then to be applied to solving five fundamental problems which inhibit growth and development:

- -inadequate income growth
- -hunger
- -health deficiencies, especially infant and child mortality
- -illiteracy and lack of education
- -unmanageable population pressures

There are also a number of "special initiatives" which are identified as chronic problems, crises or areas where special approaches are required. These include:

- -Central America
- -African Economic Policy Reform
- -Urbanization and the Urban Poor
- -Women in Development
- -Human Rights and Democracy
- -Trade Policies and Development

This is a general strategy document, reserving for other directives the details of how A.I.D. is to attack these problems and use these approaches. However, it is clear that the areas of trade stimulation and industrial development are affected by all of the approaches to development assistance. Further, both trade and industrial development are inextricably connected directly to inadequate income growth; thus attacking problems in the trade

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[1] U.S. Agency for International Development, Blueprint for Development: The Strategic Plan of the Agency for International Development (Washington D.C.: U.S. A.I.D., 1984).

and industrial sectors is consistent with one of the five fundamental problems identified in A.I.D.'s strategy.

There is some guidance in the Blueprint related to aspects of trade stimulation and industrial development. This includes a discussion of inadequate income growth, African economic policy reform and trade policies and development.

A discussion of inadequate income growth focuses on the fact that inadequate income growth reinforces other problems including hunger and disease. Thus a pre-requisite for solving other problems is achievement of a growth path which leads to real and sustainable increases in per capita income. Such growth will reduce unemployment and underemployment and increase the opportunities and resources available to low income groups. But chronic financial crises inhibit solutions. Thus the strategy focuses on attacking employment problems and financial crises as means of stimulating income growth. In general what is required according to the strategy is a broad revision of policies so that prices and incentives play a greater role in allocating resources, government is less intrusive and pervasive, and the economic climate is supportive of resource mobilization and transfers from abroad. A.I.D. resources can play an important role in assisting policy reform, but policy dialogue can be powerful in creating conditions more conducive to a flow of resources from other donors, foreign investors, and especially domestic mobilization.

African economic policy reform comes in for special consideration in the Blueprint. This stems from the absolute levels of poverty on the continent and the erosion of relative development indicators over the past decade. Distorted policies and adverse international conditions have meant stagnant agricultural production, excessive government involvement in often inefficient projects and programs, high levels of protection and resulting domestic inefficiency, and general deficiencies in skilled manpower and resources. A special focus on these problems in Africa has meant a strengthened donor/recipient policy dialogue and associated enhanced donor coordination as well as increased levels of U.S. assistance tied to major policy reforms.

A section on trade policies and development stresses that the major source of foreign exchange for countries is trade, with export earnings financing the bulk of imports, services and debt financing. Thus, economic growth will increasingly depend on expanded trade. Economic policies, according to the Blueprint, have a major impact on trade performance in LDCs. Overvalued exchange rates, trade and currency restrictions, domestic credit distortions and other impediments hinder exporters and bias investment and production towards the protected domestic market. Policy dialogue is the primary tool by which A.I.D. will raise

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these distortions to trade and production decisions with recipient nations.

Trade

Current A.I.D. policy guidance to Missions concerning the role of trade development in bilateral and regional programs is contained in a July, 1986 Policy Paper on Trade Development.[2] While general in scope, this statement does articulate the basis upon which A.I.D. supports projects and programs related to trade development. The essence of this trade policy is reflected in the following statement in the Policy Paper:

> "A.I.D.'s trade development policy is designed to encourage LDCs to utilize international trade as a key instrument in the process of achieving broad based, sustained economic growth,and place a greater reliance on complementary domestic competitive markets that support more open trade policies."[3]

In an environment of shrinking donor assistance, large debt service obligations, and need for foreign exchange to provide imported inputs to national development efforts, trade stimulation is essential. Only through greater capacity of LDC nations to "earn" resources for growth and development can progress be made in improving the living conditions of the poor, generating long-term job creation, and overall employment. Sound trade policies are therefore an integral part of any effective development strategy which will stimulate growth and efficient use of natural and human resources. Thus, A.I.D. encourages "appropriate" LDC trade policies and provides guidelines for designing trade-related programs and projects.

There are a number of barriers which A.I.D. recognizes to LDC trade development, which is primarily associated with a more "outward-looking" trade policy. These include:

1. traditional bias in favor of import substitution
2. prevalence of parastatal production entities and bias against private investment
3. lack of international marketing information, experience, and networks
4. industrialized countries' trade barriers and market

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[2] U.S. Agency for International Development, Bureau for Program and Policy Coordination, A.I.D. Policy Paper: Trade Development (Washington D.C.: Agency for International Development, July, 1986).

[3] U.S. A.I.D., A.I.D. Policy Paper: Trade Development, p. 6.

access policies
5. low and unstable prices of primary products
6. financing constraints and LDC indebtedness
7. increasing use of countertrade

A.I.D.'s policy position on trade in LDC's stems from three "fundamental" principles of U.S. trade policy:

1. free and open trade benefits all nations
2. fair trade is essential to support free trade
3. an effective international trading system is essential to preserve open markets and growing and fair trade.

The basic trade development policy of A.I.D. is to encourage LDCs to utilize international trade as a key instrument in achieving broad based, sustained economic growth. In doing this it is expected that there will be a greater reliance on complementary domestic competitive markets that thrive under open trade policies.

Fundamental to this policy is encouragement of larger private enterprise involvement. This is intended to place LDC economies on a sounder base of efficient production with market-based resource allocation. At the same time, there should be a strengthening of mutual economic interests between developed countries and the LDCs. This approach should encourage entrepreneurship, economic institution building, and increased use of private finances. Essential to this approach is the adoption of appropriate economic policies.

To achieve these objectives A.I.D. policy for trade development calls for A.I.D. policy dialogue, programs and projects which:

1. Establish a policy environment in LDCs which is conducive to private enterprise and expanded participation in international trade.

Missions are called upon to pursue a policy dialogue with host governments to remove existing trade restrictions and controls. Long histories of political and economic support for import substitution and anti-export bias create vested interests which are hard to displace or use more productively elsewhere in the LDC economies. Strategies for alternative employment and investment opportunities for resources displaced are therefore critical. In some instances Mission support can come in the form of direct support for a comprehensive policy reform program. In other cases A.I.D. assistance may have to be first put into overcoming fundamental fear of exposing an LDC economy to world market forces. This may be best achieved by focusing on development of a country's comparative advantage in nontraditional exports. In any project and program support care should be taken not to introduce new distortions into economies and to emphasize stability of government policies affecting trade and investment so that exporters, importers and investors can develop long-term strategies.

2. Encourage the transfer of technology, skills and information needed to expand and diversify LDC agricultural and industrial production which is based upon comparative advantage and thus can be exported or serve as efficient import substitution.

Comparative advantage is dynamic; world market forces change a country's trade opportunities, but domestic policies can likewise create new opportunities to exploit existing and future comparative advantage. Missions are encouraged to focus program and project resources on transfer of technology, skills and information required to exploit existing and to move with changes in comparative advantage. Joint ventures and other forms of cooperative business relationships can serve as sources of such technical assistance to LDC private enterprises.

3. Support trade and investment promotion efforts.

There are a variety of approaches available for promoting trade and investment opportunities in LDCs. In the private sector Missions are encouraged to support development of institutions which can nurture indigenous entrepreneurial talent in trade, especially exports, and attract foreign investors. Such initiatives can be centered on business associations and private financial institutions. Also assistance is appropriate to export industries as they seek to improve information and technology to enhance their competitive position. Caution is given in supporting public sector efforts at trade and investment promotion, since many are not successful and can even introduce additional market distortions into the economy. But Missions are encouraged to consider providing technical assistance to host governments in their efforts to effectively implement trade programs and streamline procedures.

4. Introduce or expand private sector competition in the export and/or import of essential or economically important commodities.

Efforts are appropriate to bring private sector actors into the production, export, and/or import of essential or economically important commodities. Often parastatal organizations have exercised monopoly control in these areas, introducing inefficiencies and budget deficits.

A.I.D. policy is to encourage dismantling of such organizations, or at a minimum efficient operation with pricing which covers costs.

5. Broaden the scope of export development projects to provide for greater U.S.-LDC two-way trade opportunities.

Missions should seek ways to encourage linkage between LDC and U.S. markets, products, and investment opportunities. This can be in the form of consulting services to help LDC producers find partners in the U.S. or even joint venture opportunities.

6. Encourage sound investments in infrastructure which strengthen an LDC's trade position.

Efforts to assist LDC infrastructure improvement should be cautious. Only in cases where a policy environment will be supportive of efficient trade and investment and the infrastructure will be self-supporting should encouragement be provided to host government efforts.

Policy Dialogue

A.I.D.'s approaches to policy dialogue derive partly from a 1982 Policy Paper.[4] Essentially this paper makes the case that inappropriate national policies can and often do diminish or negate the value of specific development projects and programs. Without a supportive environment for development, distortions make more traditional project assistance less valuable and sometimes counter-productive. What is required, then, is a policy dialogue and selective use of conditionality to encourage, even coerce governments into making policy changes. Often such changes can be encouraged by linking project and program resources to required policy changes, so that additional resources are available to governments as they alter the direction and structure of the economy. But it is pointed out that encouragement is different from the power to command policy changes.

Only where the policy changes make fundamental sense to the national governments involved is change likely; the resources of a single donor like A.I.D. are often insufficient to "buy" needed changes. What can be productive is a policy dialogue

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[4] U.S. Agency for International Development, Approaches to the Policy Dialogue, A.I.D. Policy Paper (Washington D.C.: A.I.D., December, 1982).

which assists governments in considering options for a reordering of economies, with suggestions for feasible paths to follow in such a restructuring of the economy. In the area of policy dialogue the role of other donors, especially the multilateral agencies cannot be underestimated. Much of the responsibility for policy dialogue and reform efforts lies with the host government and these multilateral agencies. A.I.D. is best able to cooperate and participate in such discussions rather than striking out on its own. This does not mean that A.I.D. cannot and should not have its own justification for policy reform and link such changes to specific resource flows. But cooperation and coordination is essential.

Private Enterprise Development

A key platform for A.I.D.'s approaches to development is emphasis on the creative role which private activities can play in increasing growth and encouraging development. This is outlined in various documents, including a private enterprise development policy paper.[5] The essence of the argument is that in too many developing nations government has taken on an excessive role both in terms of ownership of productive assets and in directly affecting resource allocation and incentives for productive activity through public policies. An economy dominated by government control and ownership diminishes the role of the individual and private initiative, often distorting and even prohibiting such participation in the economy. The result is a contribution to slowed growth, lack of development, and distortions embedded in the economy. The solution is to reduce government's role and activity, to free the creative instincts and energies of private individuals and organizations, to create incentives for mobilizing resources from private sources at home and abroad.

This strategy tends to stimulate trade development since it gives prices, domestic and foreign, a greater role in resource allocation and investment allocation. Efficiency as measured by world prices becomes more important, thus reducing the tendency to engage in import substitution behind high protective barriers. This results, often, in a different type of industrialization, since the protected sectors often are more complex, heavy industry and import substitution in these sectors is inefficient. An opening to world prices encourages, instead, those types of value added through production which are based on domestic resources and factors of production, both introducing efficiency as a more important determinant of the mix of industrial activity. Thus, privatization and the policy reforms which

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[5] U.S. Agency for International Development, Private Enterprise Development, A.I.D. Policy Paper - Revised (Washington D.C.: U.S. A.I.D., March, 1985).

stimulate it do affect trade and industrial development.

latter request was divided into: $12 million for transport, $20 million for economic policy reforms in the region, and $25 million for new regional trade promotion activities as a means of supporting a new SADCC priority in trade promotion and investment. This regional trade promotion activity was intended to: "help stimulate intra-regional trade and promote private sector investment through the provision of foreign exchange and related trade promotion services."[10]

The justification for a focus on trade touches on the linkage of trade to industrial development:

> "An area of growing concern among SADCC countries is trade, especially intra-regional trade. Recently at two separate meetings, SADCC endorsed the idea that more emphasis must be placed on the development of trade and industrial growth in the region. Such moves are positive and encouraging as opportunities exist for expanding trade. . . . The SADCC regional market of 70 million people can be served by the region's large, partially untapped labor force and a diverse natural resource endowment. With application of some economies of scale, as well as improved infrastructure, technology and management, significant new private investment and trade are possible.
>
> "In an effort to increase trade and industrial growth in the region, A.I.D. is working with SADCC to design programs to promote private investment and employment and to help stimulate trade in the region and within the Preferential Trade Area of Eastern and Southern africa (PTA), a 16-member body formed in 1981 with the goal of fostering intra-regional trade."[11]

February, 1988: A.I.D. Southern Africa Regional Budget Request for Fiscal Year 1989

The FY 1989 Budget request for Southern Africa regional programs was for US$50 million. Transport comprised $25 million, agriculture $17 million, and private sector efforts $7.15 million, of which $2.15 million was for a Trade Promotion Project and $5 million was for incremental support of an Export Pre-financing Revolving Fund which was to have started in FY 1988.

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[10] U.S., Agency for International Development, Congressional Presentation, Fiscal Year 1988: Annex I, Africa, Southern Africa Regional (Washington D.C.: Government Printing Office, February, 1987), p. 425, Annex I: Africa, p. 425.

[11] U.S. Agency for International Development, Congressional Presentation, Fiscal Year 1988: Annex I, Africa, Southern Africa Regional, p. 423.

The FY 1989 Budget request described this revolving fund activity as follows:

> "An Export Pre-financing Revolving Fund (690-0243) will be established in FY 1988 to alleviate foreign exchange constraints inhibiting exports. The Fund will be used to purchase imported capital equipment, intermediate goods, and raw materials required for private sector exports."

Details of the Regional Trade Promotion project are provided in the Planned Program Summary Sheet in the Congressional Presentation of SARP's FY 1989 Budget. Building on the observation that SADCC nations lack information and other support services for private businesses to expand trade, this project will extend the Lusaka-based Trade Information Network to industrial and business federations and chambers of commerce in the SADCC region. In addition, the project will strengthen the capacity of the Federation of Chambers of Commerce and Industry of the PTA as well as individual chambers in SADCC countries to help promote both regional and overseas trade. The project will help these private organizations to organize trade fairs and missions, collect and disseminate trade and investment information, and conduct market studies, among other services. In addition it will strengthen the capacity of Chambers to represent the interests of their constituencies in policy and economic decision-making forums. Eventually the recurrent costs of such activities are to be met by the private sector, which will also contribute staff, office space and equipment. This project is expected to result in approximately 8 private sector trade information centers in SADCC countries with trained staff capable of carrying out the objectives described above.[12]

<u>January, 1989: Southern Africa Regional Development Strategy Statement</u>

The 1989 RDSS for the period 1991 through 1995 recognizes that U.S. attention and interest is focused on southern Africa for a number of reasons, including: poverty and slow economic development; apartheid in South Africa and its impacts on neighboring countries; strategic U.S. interests in the region's resources; political impetus for peaceful, democratic regimes; and a desire to assist in the region's successful economic development. U.S. support for the region and its representative group SADCC is focused during the 5 year period on: continuing efforts to improve the physical dimensions and economic

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[12] U.S., Agency for International Development, <u>Congressional Presentation - Fiscal Year 1989: Africa, Southern Africa Regional</u> (Washington D.C.: U.S. A.I.D., February, 1988), pp. 500-511 of Annex I: Africa.

efficiency of the transport infrastructure; strengthening of agricultural research and the focus in the natural resource sector on sustainability; promotion of trade and entrepreneurship; and analysis of present and future issues facing the region.

Trade and Entrepreneurship

Explicit focus is given to trade expansion and the participation of the private sector in investment, production and exchange patterns of the region's economy. This represents considerable progress in SADCC thinking towards recognizing that the transport and communication infrastructure which is systematically being strengthened and rationalized must next be put to practical use in supporting economic growth and relations. Likewise there is a growing recognition that fiscal constraints and inefficient public sector performance require dramatic growth of private sector participation if development objectives are to be met. The approach is built around a strategy which seeks to make exports an engine of growth within a rationalized economic environment of proper pricing, market dominance, and reward for risk and performance. A program to stimulate trade and entrepreneurship will encourage and support actions in the region leading to increased foreign exchange earnings through trade in all directions and will promote wider private sector participation in market activity. Thus:

> "The U.S. program to stimulate trade and entrepreneurship will ... encourage and support actions leading to increased foreign exchange earnings through trade in all directions and will promote wider private sector participation in market activity. Improved export performance will increase available national and regional resources, thereby stimulating levels of economic growth and providing conditions amenable to development. Greater private sector participation in the region's economies will improve levels of efficiency which will benefit the region's population through lower pricing and, more importantly, will generate foreign exchange through more competitive pricing of locally produced goods on world markets."[13]

There are two elements to the program. One focuses on trade stimulation by helping SADCC as a regional grouping reduce barriers to expanded trade and by providing support to individual member nations in their efforts to stimulate trade and gain foreign exchange . The second element focuses on the growth and maturation of the private sector through improved policy climates

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[13] U.S. Agency for International Development, Regional Development Strategy Statement for Southern Africa: FY 1991-1995 (Washington D.C.: U.S. A.I.D., January, 1989), p. 48.

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and through assistance to entrepreneurs with export objectives. Both elements seek to build upon and expand the general trend in the region towards economic and policy reform, a more outward-looking focus, and a growing appreciation of the role of private sector activity, domestic and foreign, in providing the necessary resources and management skills to pursue growth and development. Assistance to each country will be tailored, within overall regional projects, to the existing and evolving economic and political conditions.

An "umbrella" trade stimulation program will be oriented towards assisting all countries in the region, but allowing the regional office to tailor programs to the specific types of assistance in each country which would lead to enhanced economic growth through expanded trade. The intent will be to stimulate foreign exchange earnings through a growth of exports among private sector producers. It will not focus on intra-SADCC trade stimulation, an illusive goal of SADCC which has been decreasing as a percent of trade flows in the region despite its prominent place among SADCC goals. Rather, the approach is to encourage foreign exchange earnings from any possible sources. Expanded resources among the nations of the region would, in turn, lead gradually to more complementarity of the region and greater exchange of goods in the region. The end result is viewed as supportive of the SADCC goal of stimulating trade in the region:

> "Expanding trade will promote growth and lead to general development, which in turn will contribute, over the longer run, to intra-SADCC trade flows and higher economic levels of prosperity in the region."[14]

Progress in each of the region's member states towards economic reforms permits a focus on stimulating entrepreneurial activity, both indigenous participation and partnerships with private investors and producers from outside.

> "The gradually improving financial conditions in most of the region's economies will permit additional entrepreneurial activity. In order to stimulate indigenous participation and encourage partnerships with producers from outside, A.I.D. assistance will support viable profit-making projects of the private sector."[15]

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[14] U.S. A.I.D., Regional Development Strategy Statement for Southern Africa - FY 1991 - 1995, p. 50.

[15] U.S. A.I.D., Regional Development Strategy Statement for Southern Africa - FY 1991 - 1995, p. 50.

Assistance will be given to encouraging and supporting viable profit-making projects of the private sector. Advisory services will be provided to assist entrepreneurs in all stages of operations. Where necessary a seed capital fund will be facilitated for project start-up costs. Financial and project evaluation services in the region will be strengthened. In general, technical assistance will be targeted to speeding the development of productive enterprises sponsored by private African entrepreneurs so that employment, foreign exchange earnings and growth are stimulated. To assure continued progress towards more conducive economic environments for private sector activity, assistance will be available to help reform regulations and policies. These and other types of assistance will stimulate private sector participation in the economies of the region, attract additional domestic and foreign capital, and provide examples of how the private sector can be harnessed to assist in expanding growth and achieving economic development.

Export Enterprise Support (EES) Project

Annex G:

SADCC on Trade, Industrial Development and Entrepreneurship

Preface:

SADCC thinking about, as well as policies, programs and projects related to, trade, industrial development and entrepreneurship are very much in transition during 1989. Old concepts are clearly being replaced by new approaches, but in a procedural, often slow, process which leaves much to be defined. The material here is a chronological overview of SADCC's evolving approach to these important sectors of the regional economy.

April, 1980: Lusaka Declaration

The Declaration of Governments establishing SADCC set down some basic development objectives:

"1. the reduction of economic dependence, particularly, but not only, on the Republic of South Africa;
2. the forging of links to create a genuine and equitable regional integration;
3. the mobilisation of resources to promote the implementation of national, interstate and regional policies;
4. concerted action to secure international cooperation within the framework of our strategy for economic liberation."

It then went on to identify areas where it was possible to reduce dependence on South Africa by increasing regional cooperation and development. Paramount among these was transport and communication, requiring coordination of existing systems and financing of additional regional facilities. The Declaration also envisaged, in the future, additional sectors where regional cooperation would be desirable.

Trade was one example used, with the Declaration saying:

> "For trade development we recognize that many of us have existing bilateral and multilateral trade and customs arrangements. But even within these constraints we believe that there is room for substantial increases in trade among ourselves. To this end existing payment systems and customs instruments will be studied in order to build up a regional trade system based on bilaterally negotiated annual trade

targets and product lists."

Other areas of cooperation mentioned were agriculture, training and research facilities, mining, industry, and energy.[1]

November, 1980: SADCC2-Maputo Proceedings

As part of the Second SADCC Conference a paper on "Southern Africa: Toward Economic Liberation - A Strategy Paper" was presented. This articulated for the first time the beginnings of a sector strategy in the areas of industry and trade. It is important to follow the industry strategy of SADCC in exploring its trade strategy. This follows from a close linkage of purpose between stimulation of regional industry and the trade linkages necessary to exchange products produced on a regional basis. It is also necessary because SADCC combines industry and trade together as a sector.

Concerning industry, the Strategy Paper specified that industrial development was necessary to reduce dependence on South Africa and create "more nationally integrated, less externally dependent economies." A 3 stage approach was spelled out to stimulate industrial development in the region:

1. Identify national manufacturing surplus capacity which could be brought into production for regional trade and to displace imports bought outside of the region.
2. Coordinate and exchange information on national industrial projects so that duplication on a regional basis could be avoided.
3. Where economies of scale dictate, seek multi-state production plants through feasibility studies and integrated planning.

In the area of trade the Strategy Paper echoed the Lusaka Declaration position that development of interstate and inter-regional trade would flow from regional strategies in energy, food security, industrial harmonization and communication and transportation, rather than "as an end in itself." It went on to indicate that for SADCC: "a standard preferential trade area is not seen as an adequate or even a necessary first step; nor is there any commitment to seek a regional free trade area or common market. Equally SADCC membership is not seen as incompatible with special interstate or regional economic co-ordination (including trade) arrangements with non-SADCC neighboring states."

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[1] Taken from:SADCC, Southern Africa: Toward Economic Liberation - A Declaration by the Governments of Independent States of Southern Africa made at Lusaka on the 1st April 1980 (London, England: SADCC Liaison Committee, June, 1980).

Treating trade as a means rather than an end in itself, the Strategy Paper concluded its sectoral statement on trade:

> "Because trade is seen as a means to benefit from production coordination, initial development policies will take place largely in sectoral discussions relating to food security, energy and manufacturing and probably especially the last of these. Because of the great significance of import licensing and foreign exchange allocation in most Member States, policies in respect to regional trade concerning these areas will receive special attention. Similarly the goal of equitable and genuine regional integration requires that in developing greater intra-regional trade, specific attention be paid to avoiding massive regional trade surpluses and deficits by different states and, therefore, to ways and means of articulating and achieving relatively balanced trade plans for exchange among partner states on a bilateral, multilateral or regional basis."[2]

November, 1981: SADCC Blantyre 1981

The Conference Overview for the third annual meeting was "Southern African Development Co-ordination: From Dependence and Poverty Toward Economic Liberation." A background paper on this subject provided a view of SADCC progress on its sectoral priorities. Industrial development appears as a separate sector, assigned to Tanzania for co-ordination. The beginnings of sector activity are described, including exchange of information among member states on industrial capacity, export potential and import requirements, all of which were intended to help identify and coordinate usage of excess capacity. Medium and longer term plans were also discussed for creating a sector coordination unit in Tanzania and for longer term coordination of joint industrial development.[3]

January, 1983: SADCC - Maseru

The Overview prepared for the Annual Conference described

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[2] Taken from:"Southern Africa: Toward Economic Liberation-A Strategy Paper" in: SADCC, SADCC2-Maputo, Proceedings of the Second African Development Co-ordination Conference, held in Maputo, People's Republic of Mozambique on 27/28 November 1980 (London, England: SADCC Liaison Committee, July, 1981), pp. 157-168.

[3] Taken from: SADCC, SADCC Blantyre 1981, Proceedings of the Southern African Development Co-ordination Conference Held in Blantyre, Republic of Malawi on 19/20 November 1981 (Blantyre, Malawi: SADCC, March, 1982).

actions taken, under the leadership of Tanzania, in the area of industrial development. These included collection of data on industrial capacity and intra-regional trade potential. A list of projects and project studies for coordinated action was also presented, with heavy emphasis on inputs to agricultural production to support coordination work among SADCC countries in agriculture.

A program for: "Industrial Coordination: Expanding Production and Exchange" was also described. This started by justifying industrial coordination as critical to development and reduced import dependence. Efficiency and adequate capacity utilization derive from regional coordination in development and utilization of industrial capacity. For this purpose SADCC strategy assigned priority for coordination of capacity to 10 key industrial subsectors: textiles, textile chemicals, salt, farm implements, tractors and components, pesticides and insecticides, fertilizers, cement, pulp and paper, and electrical equipment. In addition, other sectors to be studied for possible future coordination included: food, clothing, housing, health, water supply, power, education and transport for each of which intermediate and capital goods inputs as well as final products would be evaluated.

The links of industrial coordination to trade are seen clearly in this Overview:

> "SADCC perceives the basis of industrial coordination as being the expansion of production. Production, use of local materials, availability of important products and employment are the national and regional goals in the manufacturing sector. Intra-regional trade is not an end in itself but a means to achievement of these goals.
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> "However, trade is an important means and industrial sector coordination discussions have covered means of facilitating and expanding it. These will be explored in more depth during the coming year, particularly in respect to existing underutilised capacity in some Member States which could be used to reduce the extra-regional imports of others."[4]

<u>February, 1984: SADCC - 1984 Lusaka</u>

The Overview for 1984 reported on progress in industrial development as a sector. This included establishment of a

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[4] Taken from: SADCC, <u>SADCC - Maseru</u>, Proceedings of the Southern African Development Coordination Conference, held in Maseru, Kingdom of Lesotho on 27/28 January 1983 (Gaborone, Botswana: SADCC, September, 1983).

coordination unit in the Ministry of Industries in Tanzania, identification of potential investors for 83 out of 88 projects in the region, and focus of planned industrialization on agriculture both as a source of raw materials and as a market. This means that SADCC set a goal of processing more of its own agricultural production and manufacturing more of the required inputs to agriculture.[5]

February, 1985: SADCC 1985: Mbabane

Similar to the previous year, the Overview for the annual meeting described progress in the industrial sector. This included continuing efforts at coordination of manufacturing related to agriculture. Fertilizer as a product to be produced within the region (including some of its inputs) and as an input to regional agricultural production was specifically addressed as a pressing priority. Another priority raised by the Overview was the difficulty of member states obtaining the foreign exchange for building state-owned enterprises; private foreign investment and often foreign donors were unwilling to fund public enterprises in SADCC countries to achieve the type of regional coordination of manufacturing envisaged by the SADCC strategy. Further need for external concessional finance of such manufacturing operations was thus identified as a critical requirement to achieving some of the manufacturing coordination planned.[6]

January, 1986: SADCC Harare

The Overview, perhaps anticipating future development of a trade agenda, took specific notice of trade as an issue in the following statement:

> "SADCC has, at times, been criticised for not paying adequate attention to the expansion of intra-regional trade. Whereas there is, as yet, no formal programme of cooperation in trade, SADCC recognises the importance of coordinated action in this field. However, SADCC approaches the issue from the premise that the basic pre-requisites for a meaningful intra-regional trade systems are:

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[5] Taken from: SADCC, SADCC - 1984, Proceedings of the 1984 Annual African Development Coordination Conference, held in Lusaka, Republic of Zambia on 2/3 February 1984 (Gaborone, Botswana: SADCC, September, 1984).

[6] Taken from: SADCC, SADCC 1985: Mbabane, Proceedings of the Annual Southern African Development Coordination Conference, held in Mbabane,Kingdom of Swaziland on January 31 and February 1st, 1985 (Gaborone, Botswana: SADCC, 1985).

- -the existence of material production facilities, e.g. factories, capable of supplying the goods and services needed;
- -transport and communication systems capable of conveying the goods from and to different parts of the regional market;
- -critical inputs, such as energy,for fuelling and sustaining the productive base; and
- -qualified and competent technical, professional and managerial personnel.

"SADCC believes that the correct approach is to let production push trade rather than trade pull production. In other words, produce the goods and services first, and trade exchanges in them will follow naturally. This is not, however, to argue that there is no need to develop programmes aimed specifically at promoting increased intra-regional trade. Quite the contrary. However, SADCC's first priority has been to address the fundamental reasons why the present levels of intra-regional trade are so low."[7]

January, 1986: SADCC Intra-Regional Trade Study

This study assessed previous proposals for a SADCC trade regime in relation to the PTA and other commitments of SADCC countries. It also recommended supplementary measures that SADCC could implement to stimulate trade. As background it assessed the commodity structure and trends in intra-regional trade among the SADCC countries, reviewed existing trade regimes, and assessed obstacles to trade enhancement.

Intra-SADCC trade was found to be 4-5% of member countries' total imports and exports while the same countries' trade with South Africa was considerably higher at approximately 7% of total exports and 30% of imports. Trade between SADCC and the rest of PTA was likewise relatively small, mainly between neighboring countries. The report identified lack of complementarity between the economies of the region, especially lack of industrialization, as the cause for low intra-SADCC trade flows. But insufficient transport network, economic crises, war and sabotage activities and weak trade facilitation (high risk, lack of credit, small markets, strong outward looking trade relations) also contributed to weak trade.

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[7] Taken from: SADCC, SADCC Harare, Proceedings of the Southern African Development Coordination Conference held in Harare, Republic of Zimbabwe on 30/31 January, 1986 (Gaborone, Botswana: SADCC, 1986).

Harmonization with PTA would require SADCC to come to terms with the Most Favored Nation clause of PTA, the program of tariff and non-tariff reductions, the PTA clearing house, and the PTA Trade and Development Bank. Bilateral trade agreements could go forward among SADCC nations, but should not become a SADCC sub-regional trade system within PTA. Given these initiatives by PTA, the report recommended supplementary measures, namely establishment of a program of direct trade measures and bilateral trade agreements supported by joint trade commissions. First there should be limited agreements for specific product flows, followed by a merger of such agreements where possible. Such a program should use counter-trade measures, government support measures such as specific tariff concessions and subsidies. This should stimulate industrial co-operation ventures. If extended eventually to all PTA members, such an approach would be consistent with PTA objectives of increased intra-regional co-operation and trade.

Also recommended were an Export Pre-financing Revolving Fund and Export Credit Fund, either in each member country or on a regional basis. Specific details concerning size and coverage as well as means of protecting the viability of the funds were made. Donor assistance was also seen as a means of stimulating trade via intra-regional procurement of inputs to donor-funded projects, financing of the proposed funds, and provision of technical and financial assistance to trade promotion activities.[8]

February, 1987: SADCC Gaborone

The theme of this annual meeting was "investment in production," focusing on involvement of both the public and private sectors in building productive enterprises. This was seen as a next step after years of focusing on infrastructure in the SADCC region. A seminar for businessmen was held in conjunction with the annual meeting to obtain their views on how to increase investment in productive enterprises (reported on separately below).

The entire tone and thrust of the Overview paper was one of moderation, even accommodation with the private sector interests:

> "Member states are developing economic policies which, consistent with their distinctive national political and social objectives, are specifically designed to encourage enterprise and investment. . . .

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[8] Taken from a study prepared for the SADCC Secretariat: Christien Michelsen Institute, SADCC Intra-Regional Trade Study (Gaborone, Botswana: SADCC, January, 1986).

> "There is, in the region, an understanding of the importance of the market; and investors' concerns about the security of their investments, the need for a fair return on capital etc., are being addressed. . . . (p. 5)

What was identified as a "New Perspective" on SADCC Programs and Priorities was articulated in the paper. Consistent with prior years, the reason for initial focus on infrastructure rather than intra-regional trade was articulated:

> ". . . there was little point in concentrating attention on trade enhancement when levels of production were so low and the main constraints to trade were of a physical nature. In these circumstances intra-regional trade was not likely to grow significantly in response to classical liberalisation measures." (p. 14)

With infrastructure and service programs having achieved "a certain momentum":

> ". . . SADCC is embarking on a new phase of cooperation, the objective of which is substantially to increase the levels of material production in the region and to stimulate increased intra-regional trade." (p. 16)

To achieve this, the Overview recognized, required involvement of the business community within and from outside the region. Investment in production, perhaps unlike infrastructure, could not depend on concessional finance and in any case "the management of enterprises is not the direct responsibility of Governments." (p. 16).

A central element in this new focus on production was the establishment of a SADCC Trade Program to enhance intra-regional trade. The main elements consisted of:

a. A System of Direct Trade Measures and Bilateral Trade Agreements - "member states will consider the following instruments in this process: i. multi-year purchase agreements; ii. counter purchases; iii. preferential import licensing; and iv. product specific tariff reductions or other financial support mechanisms."
b. Preferences - "taking into account existing obligations, member States will exchange reciprocal preferences."
c. Financial Mechanisms for Intra-SADCC Trade - "in order to ease the constraints arising from foreign exchange difficulties, consideration is being given to the establishment of a regional Export Credit Facility and Export Pre-Financing Revolving Funds in those countries where such a facility is needed."
d. Trade Promotion - "a comprehensive and fully integrated trade promotion programme will be developed and

implemented." (p. 17)

Under the Sector Review part of the Overview the previous industry or manufacturing sector was expanded to include industry and trade:

> "The expansion of the SADCC industry programme into a sector dealing with both industry and trade only took place in June 1986. This development has arisen from the close inter relation between the development of industry within the region and the need for greater intra regional trade. Many enterprises, which could supply goods to the regional market, are at present working well below capacity and any large scale new investment requires the guaranteed regional market to ensure its viability." (p.39).

Commenting on the achievements to date of the Industry program, the Overview describes the portfolio of projects identified in the region as being strategic, primarily as basic needs and core industries. In addition, programs exist to strengthen industrial support services, standardization and quality control, research and development, engineering design and other product development activities, management and skills development services, industrial and consultancy services, intra-regional industrial linkages, investment policies and mechanisms, and small/medium scale technology development.

Building from this multi-year industry program, the trade program was added as a complementary element to increase capacity utilization through intra-regional exchange of goods. This trade program was also consistent with strengthening the appeal of the region to investors needing assurance of large markets for their products.[9]

<u>February, 1987: Seminar for Businessmen</u>

Held as part of the Annual Meeting, this Seminar discussed opportunities for investment in the SADCC region and explored ways to enhance cooperation between governments and the business community. The Conclusions section of the Report on this Meeting identified a number of constraints which the Seminar participants found acted as major constraints to investment and production in the region:

a. Foreign Exchange Shortages - found to discourage investment because imported inputs were not available

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[9] Taken from: SADCC, <u>SADCC Gaborone</u>, Proceedings of the Annual Consultative Conference Held in Gaborone, Republic of Botswana on 5/6 February, 1987 (Gaborone, Botswana: SADCC, 1987).

on a dependable basis and to cause under-utilization of capacity. Both tend to dampen investors' enthusiasm for new ventures. Also assurance was needed from governments that the necessary foreign exchange earnings of a particular investment would be made available if it was a net foreign exchange earner or saver.

b. Over-valued Currencies - found to distort economic choices and encourage consumption at the expense of production.

c. Attitude - found to inhibit local and foreign enterprises when government was ambiguous to hostile towards private enterprises and profit.

d. Bureaucratic Red Tape - found to be a disincentive where cooperation and speed in decision making were important. Recommended a form of "one stop service" where investors could have their requirements provided.

e. Import Duties - found to be too high on capital goods, which often undermined the financial viability of investment projects.

f. Restrictions on the Repatriation of Dividends - found to be a major disincentive in high risk and long payback projects. There was a need for security of regular dividend remittances and loan service.

g. Pricing Policies - found relative to agriculture that there was a need for realistic pricing mechanisms not favoring urban minorities at the expense of rural producers. Also there was a need for longer gestation periods and concessionary financing for medium and large scale agriculture projects, a facility not readily available from local financing institutions. For industry and commerce price controls and excise duty levels needed to be carefully monitored to ensure the continued viability of enterprises.

h. Infrastructure - found that a lack of physical and economic infrastructure, especially good transport and communications systems as well as educated and trained manpower, were serious impediments to investment.

i. Foreign Debt - found that heavy debt obligations in countries made them less attractive to investors.

j. Economic Policy Management - found that there was a need for improved macro-economic policy management.

From these observations a number of recommendations were made by the Seminar participants with a view to enhancing mobilization of domestic and foreign resources for investment in the region:

a. The role of export credit and export pre-financing revolving funds were widely endorsed.

b. A mechanism was recommended to make equity capital available to investors, perhaps through a regional stock market or regional bank for venture capital. Also existing banking and financial institutions need strengthening to become more responsive to the investment needs of the region.

c. Available investment resources should first go to upgrading and rehabilitating existing capacity, with joint ventures offering a possible means of access to capital, inputs and management skills.

d. Small businessmen and their foreign counterparts should not be overlooked since foreign investment need not always involve large enterprises.

e. Training and skills, especially business skills, should have high priority.

f. Governments should allow more resources from cooperating partners to go into productive sectors rather than restricting these partners to the service sectors.

h. There should be freer movement of capital and management skills within the region and free movement of people through easier entry and exit formalities.

i. The results of the SADCC counter-trade study should be made available since it was of interest to businessmen and a stimulation of demand and source of supply.

Finally, focused specifically on SADCC member Government policies, the Seminar recommended:

a. Efforts to revise and harmonize investment codes in the region to provide realistic and uniform incentives.

b. Increases in investment incentives, particularly with regard to long gestation projects.

c. Demonstration of greater realism in fixing currency exchange rates and determining commodity price levels.

For outside donor Governments it was recommended that fiscal and other incentives be used to increase the movement of capital to the SADCC region, in the form of special tax concessions, soft loans and seed capital among other inducements.[10]

January, 1988: SADCC Arusha

The 1988 Annual Meeting had as its theme: Development of Infrastructure and Enterprise. In the Overview a review of the Industry and Trade Sector emphasized that after the 1987 redirection of emphasis in SADCC towards investment in production this sector took "center stage" in SADCC's program of action. Among other actions the Industry and Trade Sector undertook a review of its strategy to achieve industrialization of the region based on its raw material endowments and the complementarity of production structures. New initiatives included a feasibility study of the establishment of Export Pre-financing Revolving Funds in member states, evaluation of a regional Export Credit Fund, a study to rationalize and harmonize investment codes in the region, on-going consultations with the region's business community to bring them more fully into SADCC's activities, and the establishment of a SADCC trade information center at the SADCC Industry and Trade Unit in Tanzania.[11]

January, 1988: Industry and Trade Sector Report

Additional detail on current thinking in SADCC regarding trade and industrial development is contained in the Sector Report submitted at the annual meeting. This sector report set the stage for discussing trade and industrial development by recognizing that industrial output in the region declined for a variety of reasons, including shrinking investment, shortages of foreign exchange, a heavy debt burden, weak management and technical capacity, inappropriate economic policies, and South African-sponsored military aggression and destabilization. At the same time intra-SADCC trade remained very low, at approximately 4-5% of total trade and the nations remained dependent upon imports for most consumer goods and almost all required capital goods.

Building upon the 1987 Consultative Conference theme of promoting investment, production and enterprise, the 1988 meeting sought to continue and deepen such efforts and to foster

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[10] Taken from: SADCC, Investment in Production, Report of the Seminar for Businessmen held in Gaborone, Republic of Botswana 4 February 1987 (Gaborone, Botswana: SADCC, 1987).

[11] Taken from: SADCC, SADCC: Development of Infrastructure and Enterprise, Overview for the SADCC Annual Meeting held at Arusha, United Republic of Tanzania 28/29 January 1988 (Gaborone, Botswana: SADCC, 1988).

recognition of the close links between productive activity including trade and the viability of physical infrastructure.

During 1988 the Sector therefore undertook a review of objectives and strategy for trade and industrial development. The objective was to "formulate a viable coherent strategy for the industrialisation of the region, based on its natural resources and raw material endowment."

It was also reported that some specific initiatives were well underway to assist in this review: feasibility studies of Export Pre-Financing Revolving Funds and a regional Export Credit Facility; a study of the feasibility for up-dating, rationalizing and harmonizing investment codes in the region; consultations with the region's business community to help formulate measures which would more fully include enterprise in SADCC activities; and a Nordic/SADCC Initiative aimed at promotion of investment, production and trade.

The Sector Report indicated that of 17 sub-sectors included, regional studies including sub-sector plans, project identification, promotion and implementation had been completed for:

-cement and cement products
-electrical transmission and distribution equipment
-fertilizers
-pesticides and insecticides
-pulp and paper

For trade the Report indicated that a program of action covered:

"-establishment of a trade information centre involving the collection of export/import directories, product lists and names and contact details of the companies involved;
-the promotion of direct trade measures including bilateral agreements;
-efforts to introduce a system of preferences for regional products, taking into account existing obligations of member States;
-devising a system of preferences for SADCC firms in the award of contracts;
-the setting-up of trade financing mechanisms in the form of Export Pre-Financing Revolving Funds (EPRF) in the member States, and a regional Export Credit Facility (ECF)." p. 3.

In addition the Report included the following activities related to general trade stimulation:

"The Sector also has a programme of standardisation and quality control covering such activities as the setting-up or strengthening of national bureax of standards and quality control, the harmonisation of standards and certification within the region, etc. In an effort to make maximum use, and to foster the development of the region's expertise, especially in consultancy work, the first SADCC Industrial Consultancy Services Directory is being compiled for publication; and it will be updated periodically." p. 3.

On the industrial development side the Report started by recognizing the very small proportion of industrial products among exports, which are dominated by minerals and agricultural products. The region further imports nearly all of its capital goods and most of its consumer requirements. Thus while in theory there is demand within the region for additional industrial output, in practice shortages of foreign exchange and heavy debt servicing undermine the region's industrial growth and investment climate. There is substantial capacity under-utilization in most nations and new investment, especially private, is extremely limited. Disruption of the region's economies, both for external destabilization reasons and for internal policy reasons, has built a very large back-log of rehabilitation requirements for existing industrial capacity, which when added to need for new capacity and modernization makes investment requirements exceed available investment resources many times.

The Report goes on to draw the following conclusion about an appropriate industrialization strategy:

"As long as the region lacks the capacity for self-generating growth, and depends on the export sector as the engine of growth; and its productive structures remain unable to respond appropriately to changing conditions, economic development generally, and industrialisation in particular, will be constrained. The solution lies in re-structuring the national and regional economies to make them more self-reliant, particularly in the important area of production.

"The SADCC Industry and Trade Sector will be seeking to formulate practical measures or the economic transformation of the region, based upon self-sustaining industrial production and trade.

"In most member States, reforms and other measures, aimed at the promotion of enterprise and increased production are now in place. The regional measures will, therefore, be based on, and will be designed to support and re-inforce these national measures." p. 4.

In its efforts to promote investment, production and enterprise in the region, SADCC focused on four constituencies:

- -SADCC Governments, assigned the role of providing the correct policy framework to promote production in the region;
- -SADCC's International Cooperating Partners, assigned the role of finding appropriate mechanisms beyond development assistance to support and promote investment and production in the region;
- -SADCC enterprises, assigned the role of promotion of investment and operation of productive ventures in the region;
- -Foreign Enterprises, assigned the role of channelling some of the investment resources, technology and expertise to SADCC enterprise involvement.

While the trade initiatives described above are considered by SADCC an inherent part of the Sector program of stimulating investment in productive enterprises, the main thrust of the industrial development activities is described in the Sector Report as follows:

> "The main thrust of the current strategies and programmes for industrial cooperation is the promotion of self-reliance among SADCC countries, in the production of goods and services to satisfy the basic needs of the people of the region. The following priority areas constitute the major elements of the programme:
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> - -the rehabilitation of existing industries;
> - -expansion of existing capacity or the creation of new capacity, where necessary, to satisfy regional demand;
> - -support services, covering such activities as standardisation and quality control, research and development, engineering design and new product development, the development of an industry trade information system and the harmonisation of investment policies and mechanisms." p. 6.

This set of activities can be described also as a series of industry projects, which the Report identified as 63 requiring an estimated US$ 1,216 million, of which US$ 254 million had been secured. The use of these funds includes feasibility studies and actual rehabilitation and rationalization of industry sub-sectors.

Rehabilitation of existing industries in member countries has a high priority. The objective is to complete studies which

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identify needed equipment, technical assistance, training and financing. Sub-sectors where such studies have been undertaken include: edible oils, fertilizers, foundries, textiles, iron/metal forming, and leather and leather goods.

Perhaps most illuminating of SADCC's current thinking concerning a trade and industrial development strategy is a statement about the need for a review of the Sector's program:

> "In view of the priority given to the Industry and Trade sector in the context of the Organisation's new emphasis on investment in production, and the similar focus on the Nordic/SADCC Initiative, it has been decided to undertake a thorough review of the objectives and strategy of the Sector and its relationship with the general thrust of the policy paper SADCC: Investment in Production.
>
> "This review, it is hoped, will produce a coherent, rational and viable programme for the industrialisation of the region; based on the natural resource and raw material endowment of the member States, and the need to reduce the region's imports of capital and consumer goods.
>
> "The review will also address the institutional mechanism necessary for involving the enterprise sector, and the linkages between the industry, agriculture, agro-industrial and mining sectors.
>
> "In the context of the review,the current projects in the sectoral programme will be re-appraised, in order to confirm their continuing relevance and priority. As a result of this, no details of project descriptions and costings have been included in this document."[12]

February, 1988: Conference of Businessmen

Focused on Opportunities for Investment and Trade in Southern Africa, this Conference was attended by 350 regional and foreign businessmen with the intent of promoting enterprise investment, production and trade in the SADCC region. Key constraints to industrial development and production were identified as: a decline in local and foreign investment in the enterprise sector; shortages of foreign exchange; the heavy debt burden of member countries; weak economic management and technical capacity; over-dependence on a few export commodities; acute under-employment of human capital; inappropriate economic

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[12] Taken from: SADCC, Industry and Trade Sector Report, prepared for the SADCC Annual Meeting held at Arusha, United Republic of Tanzania 28/29 January 1988 (Gaborone, Botswana: SADCC, 1988).

policies; and direct as well as indirect South African aggression and destabilization. Given the potential wealth of the region based on resources, a SADCC "comprehensive investment plan in infrastructure would be largely redundant if there were to be no investment in the productive sectors."

Key impediments to investment and SADCC efforts to remove them were identified:

1. Shortage of foreign exchange, alleviated by:
   a. Export Pre-Financing Revolving Funds
   b. NORSAD Fund (to provide seed capital and support on a revolving basis to Nordic/SADCC joint venture companies in the SADCC region).
   c. Export Credit Guarantee Facility
   d. Cross-Border Investment Facility
2. Currency exchange rates, with adjustments seen as not contributing to solutions among member countries; the problem to be alleviated by efforts to coordinate changes in exchange rates since "devaluation tends to exacerbate the problem rather than ameliorate it." A study by SADCC was scheduled to look at the relationship between national currencies among SADCC member states.
3. Policy reform, described as driven by major structural adjustment efforts of member countries (including new investment codes, improved efficiency of the bureaucracy, an easing of unnecessary controls on the economy, and a centralization of information on investment opportunities). The creation of national business councils was seen as a major step in "involving the business community in the development of the region." But reform was seen as not enough, since there was need for greater trade "among countries of the region." The thinking behind a SADCC trade strategy was presented by Dr. Makoni:

> "However our approach to increased trade in the region is not based on the orthodox trade liberalization strategies. We believe, in fact, we have observed that, reduction, or even elimination of tariffs and other barriers to trade does not always yield increased trade, in the absence of tradeable goods. For how can tariffs inhibit trade when there is nothing to trade. So in our view, the greatest single barrier to trade is lack of production. Hence, our motto LET PRODUCTION PUSH TRADE, RATHER THAN TRADE PULL PRODUCTION."

The SADCC investment plans were described for a number of key sectors with individual projects existing in the plan of action. A key concession to the changing thrust of SADCC thinking was the point made that most identified projects were expected to be executed by the enterprise (private) sector rather than by governments.[13]

February, 1989: SADCC Luanda Report on Trade and Investment

This document attempts to develop the theme for the 1989 annual meeting: "The Productive Sectors: The Engine of Growth and Development", identify measures being taken by SADCC, and propose an agenda for continued SADCC dialogue. It is not supposed to be a "blueprint" for enterprise investment, but rather "a framework for placing the enterprise sector at the centre stage of regional productive sector development."

SADCC intra-regional trade is identified as a continuing, if problematic, objective. Steps taken to stimulate such trade are identified as including bilateral trade agreements and joint commissions, both of which were seen in the report as requiring a review to increase their impact on the region's trade. Following a long period of "intensive consultations and evaluations" by SADCC of the intra-regional trade concept, the Report identifies a "formal programme" of Intra-Regional Trade Development consisting of:

a. a system of direct trade measures and bilateral trade agreements.
b. reciprocal preferences (taking into account the existing obligations of member States).
c. supplementary financial mechanisms to facilitate intra-regional trade.
d. trade promotion.

The Report further states that:

> "Work is currently in progress to develop a coherent regional industrial strategy with the major objectives of enhancing complementarity in production structures, establishing inter-sectoral linkages particularly with agriculture and mining, and creating conditions for easier access to the regional market."

Some areas where such a strategy would focus reform and simplification, to encourage private sector participation and investment, would include:

a. investment legislation and regulations

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[13] Taken from: SADCC, Southern Africa: Opportunities for Investment and Trade, Proceedings of the Conference of Businessmen held in Harare, REpublic of Zimbabwe 8-9 February, 1988 (Gaborone, Botswana: SADCC, 1988), pp. 1-5.

b. movement of capital, dividends and profits.
c. taxation, fiscal and monetary incentives.
d. flexible pricing and marketing controls.
e. enhancing administrative and institutional efficiency.

Recognizing the need for more active participation by the business community in regional investment, production and trade, the Report stresses that the previously endorsed concept of SADCC Business Councils should move forward: "to promote dialogue and coordination with the enterprise sector, and to provide a forum for the business community to have an input to matters of regional cooperation in SADCC." In general terms the Report views the councils as fulfilling a particular regional need: "In order to formalise relationships, and create a sense of certainty and obligation with regard to business dealings, there is need for Business Councils to establish mechanisms to enable businessmen to enter into contractual arrangements. ... To facilitate efficient coordination of investments, production, and trade at the regional level, it is important that a 'focal point' be established at each national level, preferably a suitable parastatal or the business council with appropriate delegated powers."

At a broader level of business confidence, the Report hints at the responsibility of Governments to create conducive environments within which risk and reward are possible:

> "SADCC member States recognise that in the area of investment in production, the enterprise community must play a primary role, and have often stated their commitment to take appropriate measures to facilitate this process. What now remains is the translation of this 'political will' into concrete and practical actions to establish a conducive investment environment. In order to allay the states concerns of the business sector, it is important that governments periodically re-affirm this political will and commitment, both at the national and regional levels."

In return, the Report identifies what SADCC expects from the enterprise sector:

> "SADCC member governments welcome and recognise the important role played by the enterprise community in the promotion of investment and production in the region.it is necessary for the enterprise community to reciprocate by showing a long-term commitment to the economic development of the region. So far, SADCC has nurtured the establishment of the business councils. It is the responsibility of the business community to ensure that these work, and provide an effective instrument for business contacts throughout the region and a forum for addressing issues of concern to the

business community.[14]

February, 1989: Industry and Trade Sector Report

The theme of the 1989 Conference focused on "SADCC-Productive Sectors - Engine of Growth and Development." The Industry and Trade Sector Report prepared for the Annual Meeting continues to place the sector at the center of SADCC's new thrust of promoting enterprise, investment and production in the region.

The Sector Report defines the policies and strategies of the Sector in January, 1989 as follows:

> "The policies and strategies for the Industry and Trade Sector are intended to achieve the SADCC objective of reducing dependence on the import of manufactured goods and services. The proposed SADCC Industrial Strategy will therefore, among other things, have to emphasize the production of intermediate and capital goods, to support the production of final consumer goods, using natural resources of the region. The result must be a self-sustaining regional industrial sector which is fully integrated with other economic sectors. The Committee of Ministers of Industry and Trade recently approved a framework document which will provide the basis for formulating a detailed strategy and concrete programme of action for the sector. Ministers also set up a committee of senior officials from five member States, some academics and practicing businessmen to draw up the industrial strategy, in accordance with the framework document."[15]

Progress was reported on a number of studies and improvements by the Sector Report, including:

1. Study of existing trade flows among SADCC countries and with countries outside of SADCC was being finalized.
2. Study of Export Pre-Financing Revolving Funds (EPRFs) was completed; on the basis of this report arrangements have been approved by SADCC for creation of schemes in Angola, Lesotho, Malawi, Mozambique and Zambia and the

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[14] Taken from: SADCC, SADCC: The Productive Sectors - Engine of Growth and Development, Southern African Development Conference, Luanda, People's Republic of Angola 1-3 February, 1989 (Gaborone, Botswana: SADCC, 1989).

[15] SADCC, Industry and Trade, Mining, Tourism Sector Report, prepared for the SADCC Annual Meeting held at Luanda, People's Republic of Angola 1-3 February, 1989 (Gaborone, Botswana: SADCC, 1989) p. 5.

expansion of existing schemes in Tanzania and Zimbabwe. This type of assistance is intended to provide foreign exchange to allow producers of exportable products to import inputs and other requirements.

3. Study of a regional Export Credit Facility (ECF) was being finalized. This facility is intended to meet the help meet the pre- and post-shipment credit problems of the region's producers and thus allow them to offer their customers more competitive credit terms.
4. Study of the harmonization of investment codes in the region was being finalized.
5. Study of a Cross-Border Investment Facility, intended to promote joint ventures across SADCC national boundaries, has been commissioned.
6. Study of the General System of Preferences (GSPs) and how they may support the expansion of SADCC exports to developed countries has been commissioned.
7. Study of how to enhance the participation of SADCC firms in the execution of regional projects and supply of goods and services procured under donor financing has been commissioned.
8. Study of existing bilateral trade agreements between SADCC countries has been completed and recommendations have been made for their improvement and more effective operation.
9. Efforts were being planned to intensify efforts to include the region's enterprise community in the mainstream of efforts to promote investment, production and trade in the region. The SADCC Business Councils to be formed and/or designated in each member country were seen as an important element in this effort and should be supported for effective operation and dialogue.

Unlike the 1988 Sector Report, in 1989 the portfolio of projects designated was identified. It included a total of 103 projects, of which 86 were for industrial investment, 7 were for trade development, and 10 were for Industry and Trade Support Services. The total cost of these projects was estimated at US $1,484.92 million, with 82% consisting of foreign exchange costs. Through February, 1989 18 of the projects had been completed and 29 others were under implementation. The remainder are potential projects yet to receive funding from donors and member countries.[16]

March, 1989: Draft SADCC Industrial Development Strategy

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[16] Taken from: SADCC, Industry and Trade, Mining, Tourism Sector Report prepared for the SADCC Annual Meeting held at Luanda, People's Republic of Angola, February 1-3, 1989 (Gaborone, Botswana: SADCC, 1988).

The proposed Strategy recognizes that SADCC is decentralized with sovereign member states. A common industrial strategy would imply "harmonization of external trade policies (ultimately, a common tariff) and of exchange rate, fiscal and monetary policies in addition to a unified investment strategy." Full policy harmonization is seen as a long-term objective, beyond the ten year time-frame of the industrial development program proposed, but an objective which should be furthered by the proposed strategy and program of action.

Differing national development objectives and approaches mean that the aim of a regional industrial strategy must be to establish a broad, comprehensive framework that reconciles national and regional interests and to which all member states can subscribe. It must recognize investment and trade as two crucial elements. Therefore the strategy must encourage both, with a focus on regional cooperation rather than the current competition among member states for industrial development projects. Industrial strategy and international trade policy are seen as inseparable given the region's open economy. This means that a trade diversion pattern of regional industrialization would only temporarily accelerate industrial growth. Long-term efficiency and viability must be achieved by ensuring that investment decisions are made based upon prices and costs of factors of production and resources, including foreign exchange, labor and capital, reflect underlying market forces.

A viable regional strategy for industrial expansion is seen as:

a. improving access to markets
b. improving access to essential inputs
c. increasing investment in new and rehabilitated industries
d. increasing emphasis on all aspects of market development
e. adopting policies designed to speed up the transfer of technology to SADCC manufacturers

Specific strategies for achieving this desired industrial expansion would include:

a. export promotion and efficient import substitution
b. exploitation of linkages with domestic resource-based activities
c. regional coordination to promote specialization so that import substitution in intermediate and capital goods can be efficient
d. targeted export promotion based on international comparative advantage.
e. improved investment climate and policies to encourage savings and improve the financial intermediation process nationally and regionally
f. removal of import repression so that spare manufacturing capacity can be used and efficiency raised

g. targeted human resource development to reduce dependence on expatriate skills
h. provision of industrial support services.

The issue of regional cooperation and balance of industrial activity is raised and recognized as increasingly divisive. The conflict between efficiency, which might dictate additional polarization in locating industrial capacity throughout the region, and equity of regional location is real and the Strategy proposes to deal with it as follows:

> "Some economic efficiency may have to be sacrificed, during a transition period, to achieve greater equity and balance in regional economic growth."

This is recognized as a dilemma requiring a sacrifice to achieve a more even distribution of industrial capacity:

> "While there is no ideal mechanism for achieving an optimal trade-off between economic and industrial efficiency and regional balance, further industrial polarisation will occur, unless concrete measures to secure more balanced regional development are adopted. Accordingly active policies to develop cross-border investments, by way of corporate coalitions, will be pursued. SADCC's role will be to foster and co-ordinate such activities thereby achieving a more equitable regional pattern of industrialisation but one that does not undermine economic efficiency by encouraging the establishment of industries where they would not be viable or internationally competitive. SADCC will be responsible for a combination of appraisal and co-ordination at the technical and project level on the one hand and policy initiatives on the other. Final decisions on regional industrial polices, project priorities and the allocation of SADCC projects to member states will be made at the political level."

At the policy level, the industrial strategy requires far reaching actions and financial conditions. First, appropriate macroeconomic policies are required to convince entrepreneurs and investors that their involvement is safe and prudent. Such a policy environment must be undertaken by each member country. Second, there must be an appropriate trade development policy; SADCC's Trade Programme is identified as consisting of:

a. developing a system of direct trade measures and bilateral trade agreements designed to increase trade flows and help new product flows linked to industrial cooperation projects.
b. extending to non-PTA members of SADCC preferences within PTA

c. establishing trade-financing mechanisms for intra-regional trade, including an Export Pre-Financing Revolving Fund and an Export Credit Facility
d. encouraging trade promotion programs
e. creation of trade coordination mechanisms.

But these steps to encourage trade must be put in the appropriate context:

> "While special mechanisms for the promotion of intra-regional trade are called for to meet SADCC's overall objectives, (and some have been adopted in the Trade Programme) exporters should be encouraged to exploit market opportunities wherever they are identified. Policies narrowly-focused on regional trade promotion run the risk of creating a high-cost industrially-inefficient regional trading bloc at the expense of international competitiveness. By contrast, an export-led growth strategy emphasising market-influenced exchange rates and increased import volumes will substantially widen the regional market while ensuring that high-cost and inefficient 'trade diversion' is minimised."

Other areas of policy action include efforts to balance regional trade through the PTA Clearing House and administrative actions to encourage trade to regional partners; harmonization of tariff protection; coordinated documentation in the region; export credit facilities; capital market development and increased domestic savings to provide capital for industrial expansion; creation of investment codes to raise inflow of foreign investment; creation of a cross border investment fund to provide foreign exchange necessary to raise member state investment in the region.

Specific focus is given to the involvement of the enterprise community. Moving away from past SADCC programs which focused mainly on public sector projects, it is expected that in the future: "The enterprise community should be encouraged to invest in new and existing projects with SADCC playing a facilitating role, by setting up trade agreements, financing arrangements, a payments clearing house, etc." SADCC can promote increased domestic and foreign private investment by ensuring better market and investment information, reducing investment risk through investment guarantee agreements, and by promoting a stable and positive investment environment.

The concept of business councils is endorsed since they are seen as "providing a mechanism through which investment and trade opportunities can be publicised and which would provide a forum for the exchange of ideas between the public and enterprise sectors." The value of having strong business councils participate in shaping and implementing investment strategies is also recognized: "Within these bodies there exists considerable experience in the fields of project preparation and financing." Linked to strong national business councils is the concept of a Regional Business Council to coordinate the activities of the respective national business councils: "The Regional Business Council will have a permanent secretariat to co-ordinate business council activities and promote the implementation of SADCC's industrial development strategy."

To achieve this ambitious reform of SADCC industrial and trade strategy has "far-reaching" implications for the Sector Coordinating Unit. Thus:

> "It is imperative to strengthen the institutional framework by ensuring a more entrepreneurial and business-oriented culture, and achieve closer cooperation between the enterprise sector and the SADCC administration. The Industrial Development Strategy outlined above has far-reaching implications for the Sector Coordinating Unit in respect of the volume and mix of resources and skills required to efficiently implement such a programme."[17]

[17] Taken from: "SADCC: Industrial Development Strategy 1989" draft March, 1989.

Export Enterprise Support (EES) Project

Annex H:

Relation of Trade and Industrialization to Economic Growth and Development: Perspectives from Economic Theory

Preface:

There is a solid underpinning from economic theory for trade and industrialization as inherent parts of economic growth and development. Both are high on SADCC's list of priorities. Both are also inextricably intertwined in the proposed project to support trade and entrepreneurship in Southern Africa.

The comments below provide background to the criteria proposed for selecting "productive" activites to support in the SADCC countries and on a region-wide basis through SADCC. U.S. AID cannot support the entire spectrum of trade and entrepreneurship activities in Southern Africa in any case. But as important as establishing criteria for limiting activities supported is a rationale for enhancing those activities with highest potential for assistance to the region's trade and entrepreneurial flows and levels.

Introduction

Too often there is confusion concerning the roles of trade and industrialization in stimulating economic growth and bringing about development. Such confusion has, in the past, led to massive import substitution under conditions of inefficiency. Instead of freeing a country from dependence on trade, such a strategy often merely changes the type of import dependence. At the same time, inefficient production entities, as measured by world or even regional pricing standards, leave a country with either factories operating at low levels of capacity and/or financial burdens of subsidizing domestic producers incapable of surviving competitive pressures. Lastly, such import substitution strategies usually are pursued through excessive levels of protection and over-valued exchange rates, both introducing continuing distortions into the economy. For these reasons, it is important to be clear about the appropriate roles of trade and industrialization. This is possible if the process of economic growth and development are defined and related to the economic activities which cause them to prosper or stagnate. It i. a hypothesis of this paper that issues of trade and industrialization cannot and should not be separated; they are inextricably linked and both have major impacts on growth and

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development.

Definitions

There is considerable consensus among economists about the ways in which international trade interacts with the industrialization process and contributes to growth and development. Here the following definitions are useful:

<u>international trade</u> - applies most broadly to the exchange of goods and services across national boundaries; often it includes combined exports and imports as a measure of the impact the rest of the world has on a national economy; broadly it includes exchanges of goods and services under all arrangements: foreign exchange, barter, counter trade (although not all arrangements are equally desirable). In many cases focus is separately on exports or imports, on trade with individual entities or groups of countries, or otherwise fragmented from total trade flows.

<u>economic growth</u> - describes increases in income levels and earnings, either in current nominal or constant real terms and either in aggregate or in per capita terms.

<u>development</u> - relates to a process of transforming and expanding supply capabilities across a broader range of outputs, presumably produced by more efficient procedures so that the "home" products can compete effectively either with "outside" products as exports and/or with imports as potential competing sources of supply.

<u>industrialization</u> - an improvement in existing manufacturing entities and the addition of new ones based upon efficient use of domestic resources, including labor, which is combined with capital, domestic and foreign, to transform production, lower per unit costs, improve quality and timeliness of delivery, strengthen marketing, and take advantage of appropriate technology while gradually increasing domestic value added. Too often industrialization is used to mean heavy, sophisticated, capital-intensive production; this is not inherent in the definition nor necessary if countries expand production, processing and manufacturing around areas of comparative advantage.

International trade has a number of impacts on a nation, all potentially contributing to the process of growth and development while exercising major impacts on the size, composition and efficiency of industrial activity:

-exports expand output beyond national demand and generate additions to income through demand for local inputs and generation of "value added" payments as interest, rent and wages/salaries.

-imports open up the range of goods and services available beyond that which can be produced locally, providing higher quality and lower price options.

-specialization in production for export and efficient supply to the home market result in economies of scale from larger-scale production, division of labor, cost-savings in procurement, management and marketing. This lowers the costs of production for home goods which complements the potential cost reductions from importing goods and services produced inefficiently at home.

-increasing incomes, from higher production for export and lower costs of cheaper imports, expand aggregate demand, leading to higher production, savings, and investment in a process of accumulation that stimulates the development process.

-demonstration effects through trade of introducing new products, initially as imports, which eventually can become the basis for import substitution and industrialization where there is a comparative advantage and as the home market demand rises.

-new technology, world standards of quality and timeliness of delivery, and stimulus to broader "outward" looking orientation flow from expanded trade. This is an intangible but very real stimulus to entrepreneurial instinct in a supportive financial environment.

-competition is heightened by trade, requiring export and import substituting producers to master high world standards, keep up with new products and tastes. It also tempers monopoly pricing in small, previously protected markets.

Impacts of Trade

While trade offers these as possible benefits, there are also costs. These arise from an "opening" of the domestic markets and an outward orientation of production towards export opportunities, as well as import substitution where it is efficient. More trade may not always be more desirable. It requires a balancing of the benefits against costs, which may be transitory or more permanent. There are disruptions to and

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vulnerability of a more open economy, including: changes in terms of trade; alterations in tastes and markets; capital flows; changes brought about by technology transfer; dependence on imports for some raw materials, intermediates and capital goods; presence of foreign capital and management; and a host of other impacts stemming from the opening of an economy through trade expansion and its resulting changes in production patterns. Trade policy therefore becomes a process of consciously establishing and implementing a strategy which takes maximum advantage of the benefits from trade, while seeking to minimize the costs associated with expanding trade's role in the economy. Inseparable from this process is the determination of resulting production patterns, including agriculture and services as well as manufacturing, or what is often termed industrialization.

Trade expansion should contribute to the growth process, which, in turn, stimulates economic development. However, development strategies do not always result in growth or trade expansion. The nurturing of development through expanded production for the home market (often import substitution) or for possible export can only be beneficial in the long-run if it is efficient by world or regional standards. If such development is achieved behind protective barriers to competition and with other types of subsidies, then the consumers of such products pay higher prices in the home market and must be subsidized in the export market. Limits on borrowing capacity, internal and foreign, restrict the time such a development strategy can be pursued, while in the process limiting incomes generated. Thus, a country can foster some inefficient development by modest reductions in growth. But the costs must either fall as the inefficient development "matures" towards greater efficiency, or there must be continuing subsidies which divert resources from more productive uses.

Regional Trade Initiatives

Groups of countries can attempt to modify the trade process through preferential exchanges behind common barriers to outside trade. This can result in a regional distribution of production which attempts to mirror world patterns. At some cost of foregone "outside" efficiencies in procurement, members of the regional trade group can direct export production towards the larger regional market (assuming the reduced or tariff free internal price is lower than the tariff-laden external price, an assumption not always true, leading often to quantitative restrictions against "cheap" foreign goods). But such regional groupings must be constructed carefully so that there is complementarity of production and consumption This is necessary to allow for a roughly equitable distribution of the gains from the regional grouping among all of the members (short of which subsidy mechanisms are necessary to keep the non-benefiting countries within the regional trading arrangement where they pay

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higher than world prices for products).

Import Substitution

Import substitution is an important but widely misunderstood element in the growth-development process. Imports make available raw materials, equipment, technology, and consumer goods impossible to produce efficiently in the home market. But a natural part of the development process is expanding demand for imports. As scale-economies proceed, home demand for some imported inputs and consumer goods rises to a level where domestic production is possible, resulting in import substitution. As this starts "infant" new production arises, initially at a small-scale with considerable inefficiencies. As production rises to meet expanding demand, there should be improved efficiencies and falling costs. Eventually home production of substitutes should be as efficient as the alternative imports. Interim protection of the "infants" is a tricky business since the maturing process is painful and vested interests soon arise agitating for extended if not permanent protection. But many would say that at least within the manufacturing sector import substitution should be synonymous with the initiation of industrial development.

If this process of domestic production responding to growth of demand operates well, import substitution is a passing phase, sector by sector, of replacing initial import levels with home production. Subsequent expansion of output is then a result of growth of domestic demand interacting with expanding domestic supply capabilities. In fact, the mature phase of production may see higher levels of imports than the initial levels before substitution, resulting in imports competing with and thus disciplining efficient domestic production of the same item which underwent the "import substitution" process. A desirable end result may even be exportation of the item initially produced as an import-substitute.

Export Strategies

A healthy rate of import substitution is largely determined by export expansion and overall economic growth rather than more direct Government efforts to accelerate and stimulate import substitution as a catalyst to presumed industrialization and growth. Thus:

> "Exports and economic growth lead to increased imports and foster a 'natural' process of import substitution, based on a combination of transport cost protection (most industries tend to locate near markets or raw material supplies for reasons of transport costs), scale economies, improved infrastructure, and growing capabilities of the labor force, making new industries

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profitable. This natural process can sometimes be hastened through protection, subsidies, or other incentives, and governments can sometimes improve the results through direct attention to the quality, scale, and timing of the industrial process. But by itself, such attention may be misplaced without major efforts to promote exports and growth at the same time."[1]

Export expansion thus becomes an important stimulus to the growth and development process, perhaps even an essential component of sustained rapid growth and development over the medium-term. Exports facilitate the benefits of the trade process described above. Exports are a country's means of "earning" the resulting imports required to achieve development and broaden the range of goods and services available under growth. They likewise allow a country to service debt incurred by borrowing against future expanded foreign exchange resources. Related to industrialization, broadly construed, exports promote the use of domestic factors in abundant supply and increase demand for domestic inputs (providing multiplier stimulus to other sectors of the economy) and imported inputs which can trigger the import substitution process (described above) as a desirable path to additional domestic production of manufactured goods. Thus, export expansion and "efficient" import substitution are basically complementary, not competing, as strategies for growth and development.

Protection

Protection is often used to stimulate import substitution, with the objective of promoting growth and development through broader industrialization. Even when import substitution is stimulated by expanding export production and resulting demand for inputs, initial home production of import substitutes is often inefficient and higher cost to producers than continued use of imports. But protection of nascent import substitution industries may impart on export producers (as well as producers for the domestic market requiring such inputs) higher costs, thus reducing their competitiveness and threatening the export-led process of growth and development. A combination of export taxes on traditional commodity exports (to stimulate greater processing and diversification into non-traditional products), appropriate exchange rates, and selective tariff protection for high priority import-substitution may be superior to placing the full burden of trade stimulation on tariffs and especially on quantitative restrictions against imports.

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[1] Donald B. Keesing, Trade Policies for Developing Nations, World Bank Staff Working Paper No. 353 (Washington D.C.: World Bank, August, 1979), p. 11.

Development Strategies

There is increasing hope that in the future developing economies will follow a path towards growth and development closer to the "theory" described here. The world recession of the 1980s, dwindling net resource flows, and an inability to sustain the public and private financial implications of continued support for inefficient producers all point towards a more outward looking, open strategy for trade and production. This inevitably means that products whose processing and manufacturing build on domestic input availability and efficiency will have a greater chance of being exported. It also means that additional import substitution will proceed more often in cases where it is economically justified and offers the prospect for self-sufficiency after the infant industry interlude is over.

The past has left a heavy legacy which must be addressed; existing inefficient producers must either be made self-sufficient, or eliminated if the financial subsidies are to be reduced and eventually stopped. In the interim, inefficient domestic producers handicap the operation of other producers for the home and foreign markets through high input costs. They also discourage the creation of new producers more aligned with efficient use of domestic inputs. Thus, there is need for a transition process during which countries are able to sort out which production entities can be made efficient and which need to be dismantled. There are various terms for this process, in some countries restructuring is appropriate while in others rehabilitation describes what must be achieved. In all cases the process required is analogous to "triage" where the wounded are divided into three groups: those capable of surviving without assistance, those which will expire regardless of assistance, and those which can survive with timely help. Similarly in cases of ailing industries, countries need to determine which sectors and firms can survive under existing economic conditions (and therefore would do even better as policy reforms improve financial incentives and resource allocation), which have no realistic chance of operating without excessive subsidy and thus must be dismantled, and finally those sectors and firms which are troubled but with aggressive assistance can become efficient.

Pursuing the objective of promoting greater efficiency, and realizing that this often means a reduced or eliminated role for public participation in production, donors can contribute to appropriate industrialization of Southern African economies by supporting restructuring and rehabilitation efforts. As a more appropriate policy framework is being put in place, assistance to production entities capable of achieving increased efficiency makes sense as a contribution to the Southern African region's economic strength, increasing options for intra-regional trade and decreasing dependency on South Africa. Likewise, efforts towards an orderly close-down of hopelessly inefficient production entities can assist governments to use their resources to better advantage. Neither of these involves donors in supporting industrial projects in the traditional sense; rather, what may well be needed is managerial, engineering and consulting assistance to restructure, capture efficiencies and otherwise improve operations. Bridge loans to assist in such structuring and rehabilitation might be appropriate for donors and investors. As a regional program for Southern Africa, such assistance might logically be confined to those regional industries with potential for servicing multiple national markets, making them appropriate recipients. National programs of sector adjustment and rehabilitation, supported by donor assistance, would be complementary and assist firms serving national markets.

Constraints

There are at least three conditions which tend to detract from the ability and/or willingness of developing nations to pursue such an agenda of outward looking growth and development. First, external shocks are unpredictable but often devastating to small countries. An open strategy of development can make nations more vulnerable to such shocks, be they drought, world recession, or vulnerability to regional influences such as South Africa's impacts on neighboring countries. Second, industrial country protection and the aggressive growth of newly industrializing nations, primarily in Asia and the Pacific, threatens to close some of the very markets where developing nations might find initial outlets for their exports. This is a serious blow to the idea of an open world economy where nations can base economic activity on comparative advantage and find willing buyers. Running partly counter to this are preferential trading arrangements for developing nations, including the Lome Convention and the Generalized System of Preferences, although both exclude some products which threaten developed markets. Third, domestic vested interests must be recognized as a potential deterrent to economic reorganization. Given several decades of import substitution leading to embedded inefficiency, all manner of groups are threatened by moves towards basing production on efficiency standards and reducing subsidies and protection for the inefficient. The inability of governments to continue subsidizing production and carrying out policies which discourage efficient production tends to diminish the power of such vested interests, although their power and control over development strategies should not be underestimated.

Export Enterprise Support (EES) Project

Annex I: Description of Central and Regional Projects

This Annex describes the principal projects, sponsored by A.I.D. Central and Regional Bureaus, that represent potential sources of technical assistance expertise which could be accessed by the EES Project on behalf of SADCC governments, private sector organizations and firms, and USAID Missions in the region. These summaries include information on the sponsoring Bureaus, the issue areas covered, the main contractor firms involved, and where available the time periods for each central contract.

1. <u>Private Enterprise Development Support (PEDS) Project</u>

The PEDS project (PDC-2028-Z-7186-00) is sponsored by the Bureau for Private Enterprise (PRE). Its purpose is to provide a comprehensive range of professional services on private enterprise development issues to USAID Missions, governments, and private sector entities. The PEDS project runs from 1988-1992, with a potential extension. The project offers a Mission/Bureau buy-in provision, as well as possible full or partial task funding from PRE central funds.

The accounting firm of Arthur Young provides overall management to PEDS, as well as technical assistance on project development and financial and informal sector issues. The Arthur Young consortium includes the following firms. SRI International examines issues related to macroeconomic and international economic issues, project development and evaluation, investment promotion, capital market development and trade/investment policies. Management Systems International specializes in project design, implementation and evaluation, management training, institution building and small and micro-enterprise development. Austin and Associates has developed a Manual for Action in the Private Sector (MAPS) methodology. The Services Group provides expertise on free zone development and industrial zone planning. Multinational Strategies undertakes business climate assessments, strategic planning and international marketing. Additional firms in the consortium include Trade and Development International Corp., Robert Carlson Associates, Elliot Berg Associates, Ferris & Company, Metametrics, Roney Consulting and Curtis, Mallet-Prevost, Colt and Mosle.

2. <u>International Executive Service Corps (IESC)</u>

The Bureau for Private Enterprise has extended a core grant (940-0012) to support the IESC worldwide volunteer executive (VE) program. The grant runs through 1993, and provides managerial

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[illegible] technical skills or [illegible] to small and medium size private enterprises. The IESC network includes [illegible] field [illegible] and a skills bank of 9,500 registered VEs. An additional [illegible] (PDC-0012-A-00-8160-00) with IESC is for a pilot [illegible], Trade and Investment Service (TIS). The purpose of this activity is to coordinate a multi-industry promotion and technical assistance program. The latter activity is being co-financed by PRE and the Guatemala, Morocco, Egypt and Yemen USAIDs.

3. <u>Growth and Equity through Microenterprise Investments and Institutions (GEMINI)</u>

This project is sponsored by the Bureau for Science and Technology (S&T). It will provide technical assistance, research and institutional support in microenterprise development to USAIDs, U.S. and host country PVOs, and other institutions that work with microenterprises. Gemini is intended as a follow-on project to S&T's ARIES Project (Assistance to Resource Institutions for Enterprise Support, 931-1090). ARIES covers three integrated components -- applied research, training and technical assistance -- with the goal of making resource institutions more effective in serving local entrepreneurial needs, as well as helping USAID programs which support these institutions.

ARIES is implemented under a contract with Robert R. Nathan Associates. Subcontractors in the consortium include Harvard Institute for International Development (HIID), Control Data Corporation (CDC), and Appropriate Technology International (ATI). The ARIES project runs through 9/30/90.

4. <u>Consulting Assistance in the design and implementation of Economic Reform (CAER) Program</u>

This newly-established program is sponsored by the Bureau for Policy and Program Coordination (PPC). It provides policy-related consulting and advisory services, by economists and other social scientists, to assist A.I.D./W, Bureaus, Missions, and host country governments in the design and implementation of policy reform programs. Issue areas covered include monetary, fiscal and exchange rate policies, effects of policy reforms on different social groupings, and reform sequencing. A formal bidding process is currently being completed, and negotiations are under way with the firm/consortium selected. The program will extend from 1989 to 1992.

5. <u>Africa-Wide Private Sector Development (APSD) Contract</u>

APSD is a recently established Indefinite Quantity Contract (IQC) sponsored by the Regional Development Office/Southern Africa (REDSO), and administered in both Nairobi and Abidjan. The IQC provides services in six areas of technical assistance related to private sector development: Policy reform, capital formation and mobilization, export and investment promotion, human resources development and training, business development (including small and micro-enterprises), and privatization. The IQC runs through 1991.

Two contractor consortia hold this IQC. One is led by the accounting firm Deloitte Haskins and Sells (DHS), which specializes in privatization and business development. Included in the DHS consortium are SRI International (export and investment promotion), The Aries Group, LTD (capital formation and mobilization), Elliot Berg Associates (policy reform), The Hay Group (manpower development and training), The Services Group, Atlas Associates, A.T. Kearney, the law firm Duncan, Allen and Talmage, Women's World Banking, and The Schroder Group.

A second contractor consortium holding this IQC is led by the accounting firm, Arthur Young and Company. The Arthur Young team includes three core firms and eight resource firms with specialized expertize. Arthur Young holds substantive responsibilities for privatizations and capital formation and mobilization. Robert R. Nathan and Associates covers export promotion and policy analysis. Management Systems International (MSI) is responsible for human resources and business development. Resource firms include AMEX, Atlas Associates, Duggleby and Associates, First Washington Associates, IESC, TIPCO, Trans-Atlantic Consulting, and VITA.

6. <u>Macroeconomic Services IQC</u>

The Bureau for Program and Policy Coordination (PPC) sponsors an Indefinite Quantity Contract (IQC) for macroeconomic technical services. This IQC was initiated in 1986 and ends in 1989, but a follow-on IQC is in the process of re-bidding. The purpose of the IQC is to offer Bureaus and Missions easily accessible technical assistance resources on economic analysis issues. These include monetary and fiscal policy, trade and foreign exchange policy, investment and business regulations and procedures, modelling, and public/private sector policy mixes. Current holders of the IQC are Robert R. Nathan Associates, SRI International, the International Science and Technology Institute, and Chase Econometrics.

7. Economic and Enterprise Policy Analysis (EEPA)

The EEPA project (936-5426) is sponsored by S&T, and aims to facilitate efficient policy reform and enhance enterprise development, productive employment generation and economic growth. Policies examined include pricing policies such as minimum wages, foreign exchange and interest rates, industrial location regulations, and administrative or fiscal barriers to foreign trade. The project provides policy analyses, research, technical assistance, training, institutional development and workshops. The Harvard Institute for International Development manages the project.

8. Market and Technology Access (MTAP)

The MTAP project (936-4053) is sponsored by S&T and seeks to develop cost effective, commercially viable intermediary organizations and operating methods to facilitate firm-to-firm technology transfers and improve market access. The project provides research to determine what types of intermediary operations and approaches are useful for promoting collaborative ventures between small and medium U.S. and developing country firms. The prime contractor for MTAP is Arthur Young & Company, and subcontractors include InterMatrix, BDIM and International Commercial Services.

In addition to the A.I.D.-sponsored contracts and grants listed above, several other activities involving both A.I.D. and other organizations could provide additional resources to initiatives such as those of the EES project.

9. Africa Training and Management Services (AMSCO) Project

This five-year project (698-0518) involves a $2.5 million A.I.D. grant to UNDP as part of a $21.0 million, multi-donor program designed to provide both the services of experienced expatriate managers as well as training for local managers to strengthen African enterprises. The executing agency is the International Finance Corporation (IFC), which has established the African Management Services Company (AMSCO) as a public/private limited company located in Amsterdam. AMSCO will identify African companies, assess their commercial and managerial viability, and provide managers and consultants, training and technical assistance. Program operations should begin in 1989.

10. <u>African Growth Fund (AGF)</u>

The purpose of this project (698-0528) is to stimulate growth in Sub-Saharan Africa by investing in and supporting American and local investment in the private sector. The AGF is sponsored by OPIC, and capital for the fund will be provided through $10 million in equity subscriptions and $20 million in OPIC-guaranteed notes. Citicorp Investment Bank has been retained by OPIC to market the equity subscriptions and place the OPIC-guaranteed notes. Equator Holdings LTD, a wholly-owned subsidiary of the Hong Kong and Shanghai Banking Corporation, has been selected by OPIC to manage the fund. The AGF will operate as a venture capital equity fund.

11. <u>Africa Project Development Facility (APDF)</u>

This three-year, $2.1 million project (698-0516) supports a broader $17 million donor effort to establish advisory services for private entrepreneurs in Sub-Saharan Africa in the preparation of viable projects. The facility, with field offices in Abidjan and Nairobi, works with promising African entrepreneurs during the project preparation period until funding is secured from commercial banks or other sources. The APDF is sponsored by the UNDP and the IFC, with the latter acting as the executing agency. The facility was initiated in late 1987, and will run through 8/31/90. The facility is in its second operational year and has received several hundred project proposals. Thirty projects totalling $47.1 million have obtained financing with APDF assistance.

Export Enterprise Support (EES) Project

Annex J:

BOTSWANA:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

Botswana borders South Africa, Namibia, Zambia and Zimbabwe, consisting predominately of the Kalahari Desert which accounts for 80 percent of the land mass. The climate is primarily arid or semiarid and low rainfall interspersed with periodic droughts limit agricultural productivity. A population of about 1 million lives primarily along the eastern border and is growing at 3.8 percent per year. Having gained independence in 1966, it has moved quickly from being one of the poorest countries in Africa, dependent on foreign aid, to one of the fastest growing countries with the emergence of the mining sector. The share of mining in GDP rose from 11 percent in 1971/72 to 30 percent in 1981/82 and to 51 percent by 1985/86 as new mines came on line. Growth of this magnitude has allowed the Government to build infrastructure and expand services. Supplementing this good fortune has been a rapid expansion of the national cattle herd, with beef exports growing in response to high export prices.

Currently cattle raising is the main agricultural activity, providing a livelihood for the majority of the population and providing the raw material going into the processed beef industry. Arable crop production is limited to less than 5 percent of the land and is focused almost exclusively on subsistence crops. Manufacturing is only beginning, being focused primarily on the processing of meat.

Diversification of the economy is a major objective of Government planning, with the goal of increasing labor-intensive, nonmining economic activities. Import substitution is a prime target in this regard. The close linkage of Botswana's economy to South Africa is another dimension in planning and managing the economy. Membership in the Southern African Customs Union (SACU), along with South Africa, Lesotho and Swaziland, provides nearly one seventh of government revenues, but Botswana has no control over the magnitude of this revenue which is delayed two years until receipt. Some 12 percent of the country's labor force works in South African mines, contributing to remittances but introducing uncertainty into future employment trends and policies.

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These characteristics mean that Botswana's economy has extreme dependence, both on mining as a sector for economic growth and on South Africa as an economic force. In addition it is faced with finding employment for a largely unskilled workforce in a situation where there is limited absorptive capacity for productive investment and industrial development. In this situation the growth rate, which averaged 15.6 percent during 1981/82 - 1985/86, was largely fueled by mining; real GDP growth during the same time excluding mining was only 5.4 percent. It must be recognized that severe drought during this period contributed to lower than normal nonmining activity, but in any case the economic potential of the economy outside of mining is limited and faces considerable barriers to expansion. Such constraints include a shortage of skilled manpower, high cost of developing basic infrastructure, and problems in protecting domestic production as a member of SACU.

The Sixth National Development Plan covers 1985/86 -1990/91. Its objectives are rapid economic growth, employment creation, rural development, economic independence, and social justice. The plan calls for real GDP to grow at an annual average of 4.7 percent and employment to increase at 6 percent per annum. Some 21 percent of Plan expenditure is targeted for works and communications. Approximately 17 percent is targeted for mineral resources and water affairs, while education is to receive 12 percent, health 4 percent and agriculture 4 percent.

The experience in Botswana over two decades of economic management indicates a sound strategy for maintaining growth and expanding development to key sectors of the economy. The country does not have serious balance of payments problems and has used fiscal and monetary tools responsibly. Also the Government has been able to implement necessary stabilization measures in the face of abrupt changes in export prospects. Rather, the main development problem stems from the newness of the mineral-led growth; linkages within the economy have not yet been strengthened sufficiently and other sectors of the economy have not shared directly the expansion of mining. Traditional agriculture and cattle raising remain the main economic activity for some three fourths of the population. The increasing concentration of cattle ownership and low yields in arable farming have resulted in conditions of absolute poverty for perhaps half of the rural population. At the same time, the Government has improved the quality of life for all citizens through improvements in life expectancy, infant and child mortality, and literacy. Likewise the drought has brought forward extensive relief efforts by Government directly specifically at helping the poorest groups which were hit the first.

Several aspects of economic management could be improved in spite of the sound record the Government has accumulated. Management of the public sector has been efficient. Spending has been carefully tailored to resource availability, avoidance of waste, and maintenance of accountability and effective implementation. Short and medium-term planning and budgeting have been used to achieve this level of management within the Ministry of Finance and Development Planning. The development planning exercise identifies national development objectives, the main sectoral issues, and required policy directions; these are then supplemented by macroeconomic forecasts and a list of necessary and desirable projects. But there is a need to improve the framework for consistency among the macro, sectoral and project levels of planning. Perspective and annual plans, used in many countries, could also help improve temporal consistency and continuity. Current practice is to supersede regular national development plans when called for by mid-plan changes in international and domestic economic conditions. Development planning in Botswana is made particularly difficult by the instability of export earnings and recurrent droughts. But such conditions reinforce the need for improved planning methods which emphasize counter-cyclical and medium-term programs. A long-term view is especially important so that instability in the shorter periods does not divert development from basic objectives.

Aside from difficulties in planning and implementation, Botswana's vulnerability to exogenous shocks and instability has serious impacts on the process of development itself. Unstable growth exacerbates income and wealth distribution problems since low-income groups are hurt more by and have greater difficulty in recovering from economic downturns. Investment in agriculture, especially arable farming, is made high risk due to constant threat of recurrent droughts. Heavy dependence on earnings of expatriate labor in South Africa is risky due to the large role of political elements in determining continued demand for workers in South African mines.

In such a situation fluctuations in real government revenues could lead to a build up of capacities which could be used in lean years where there is a shortage of funds. This would require an extension of counter-cyclical policy to include expenditure, especially development projects. A build up of foreign exchange reserves in prosperous years and a draw down in lean years to maintain total expenditures and thus a steady flow of project expenditure could help provide counter-cyclical stimulus to the economy and maintain progress towards completion of development projects. Maintenance of emergency food stocks of food grains and perhaps of other crucial commodities at regional centers around the country could also assure availability of consumption necessitates in times of drought or economic downturn. A policy solution to these problems, proposed by the World Bank, involves attaining a stable growth of consumption and fixed capital formation by managing inventory investment and foreign exchange reserves. Such an approach is different from a stabilization policy of the demand management type, which aims at regulating total demand to the capacity output primarily through budget deficits and surpluses. The Government of Botswana already pursues a policy of accumulating foreign exchange reserves (and cash balances) to be used in lean years. What the World Bank proposes is an extension of this practice to include improvements in longer term planning, thus mitigating the risk factor and spreading resources over a number of years and reducing the threat of short-term variations in levels of development expenditure.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

Botswana's currency unit is the pula which since June, 1980 has been pegged against a currency basket composed of the SDR and the South African rand. Monetary authorities have managed the pula exchange rate in a flexible manner to achieve both external competitiveness and to mitigate imported inflation from South Africa. This has meant changing proportions of the SDR and rand in the basket and discrete changes in the exchange rate, first in rather large amounts and then since 1986 in small but more frequent changes (less than 1 percent).

Exchange control applies to transactions with all countries. The Ministry of Finance and Development Planning delegates most administration of exchange controls to the Bank of Botswana, which in turn depends on commercial banks to carry out many of its powers. In practice exchange control is liberally exercised. Payments from and to residents of foreign countries must normally be received in a foreign currency or through a nonresident pula account in Botswana. There are no bilateral payments agreements.

There is a large rent or surplus involved in receipts from Botswana's mining operations, especially diamond mining where cost of extraction is estimated at one quarter of the total value of diamond exports. Generally an exchange rate based on a high productivity resource extraction sector is not conducive to the development of the non-mineral sectors. A strong currency leads to distribution of the surplus through cheap imports, but discourages exports due to the high cost in foreign currency to buy domestic output in the form of exports. Such a phenomenon makes difficult economic diversification and employment creation.

Discussion in Botswana has centered around the case for and against using the exchange rate to promote local production. A 1982 Presidential Commission on Economic Opportunities concluded that devaluation was not a desirable approach and that other incentives for industry, but not import duty increases, could achieve the desired objective of economic diversification. The concern was that a depreciation would fuel inflation, hurt the poor and put pressure on wages. It is clear that changes in the present economic structure require changes in relative prices, with imported goods increasing if there is to be import substitution. Such changes in relative prices can occur either through adjustments of the nominal exchange rate and or the tax/subsidy rates. There are advantages to placing at least part of the weight of adjustment on the exchange rate, even if only gradually, since tax and subsidy policies are administratively demanding. If the pula were depreciated in moderate but regular steps at a rate faster than would be warranted by the decline in rents from mineral exports, with a goal of rendering an increasing number of socially beneficial activities privately profitable, then this diversification objective could be achieved while minimizing the disruptions introduced into the current pattern of economic prices and activities.

2.B. Import Administration

Membership in the SACU means that there are generally no restrictions on movement of goods between Botswana, Lesotho, Swaziland and South Africa. Import permits are necessary, however, for most goods imported directly into Botswana from outside of the Customs Union. There are no restrictions or delays in payment for authorized imports.

Botswana's dependence on imports has declined from 78 percent of GDP in 1982 to 55 percent in 1986, but still remains high. Consumer goods have fallen from 24 percent of GDp to 15 percent over this period, while capital goods have declined from 54 percent of GDP to 39 percent. During this period total imports grew by 16 percent per annum in pula terms.

Some three fourths of imports come from SACU countries, down from 86 percent four years earlier. Increased market shares for European countries in Botswana account for this decrease in dependency on SACU imports.

2.C. Export Policies

Botswana's exports are highly concentrated; diamonds account for over 75 percent of total exports, beef 8 percent, and copper/nickel matte 6 percent. These 3 commodities total over 90 percent of all exports, up from 82 percent in 1982. Most variability in exports derives from diamonds, whose exports depend on production, quality mix, world prices, and the pula-dollar exchange rate. During 1986 the depreciation of the pula against the dollar brought about a 20 percent increase in diamond exports in dollar value terms as compared to a 17 percent in pula terms. During the period 1982-86 diamond exports increased some 50 percent in pula terms while total exports expanded by 35 percent reflecting trends in non-diamond exports. What must be recognized is that within the substantial growth rate of diamond exports over the past 5 years there has been substantial variation reflecting the sources of variability mentioned above.

Other export trends also reflect high variability. Meat exports have been affected by the quota set by the EEC and the drought. Weaknesses in the world copper market have meant a static value of copper/nickel exports. Textile exports, primarily of lower quality, go predominately to Zimbabwe which has allowed them to enter duty free. But they have not grown in value or volume terms and have fallen as a share of total exports. Other exports include leather goods, skins, candles, and other miscellaneous items, most of which are exported to Malawi under a 1956 duty-free trade agreement. While the pula value of these exports has gradually increased, their share of total exports has declined.

The direction of trade for exports is highly concentrated, with approximately 86 percent going to Europe, up substantially from 5 years previously. This is caused largely by diamond exports which primarily go to Europe; but most meat exports accounting for some 8 percent of the total, also go to the EEC.

2.D. Industrial Policies

Manufacturing activity remains small in Botswana, dwarfed by mining as a contributor to value added. The share of GDP for manufacturing declined from 6 percent in 1981/82 to 3 percent in 1985/86, partly caused by the dramatic increases in mining activity and by the continuing drought which affected the cattle herds. Over one third of gross manufacturing output is concentrated in meat and meat manufactures, having risen from 14 percent in 1981/82 to 38 percent and 50 percent in 1984/85 and 1985/86. The other major manufacturing activities are beverages, at 14 percent of gross manufacturing output, and textiles at 12 percent. Handicrafts and village industries average approximately 4 percent of total output.

Non-beef manufacturing activities have been constrained by a number of factors. The domestic market is too small to support a number of types of manufacturing which might otherwise be feasible. There is a shortage of skilled manpower. Basic industrial infrastructure is expensive to build and maintain. Transportation costs for external transactions are high given the landlocked location of Botswana. Domestic beverages as a manufacturing sector has held steady at an average share of 14 percent of total manufacturing output, but additional growth is limited by the size of the population and the growth in household incomes and consumption. Textiles, which stood at 15 percent of manufacturing value added until 1983/84, dropped to less than 6 percent when the preferential trading status with Zimbabwe was curtained in 1984/85. Exports of textiles should increase once the preferential status is reinstated.

Industrial policy in Botswana is targeted at expanding the manufacturing base, increasing the level of value added, assuring availability of training for occupations with higher productivity, and generating job opportunities in both rural and urban locations. The tools to achieve this are: general industrial incentives; a coordinated system of small-scale and informal extension services; manpower training and localization policies; active use of trade and exchange agreements; stimulation of foreign investment; provision of infrastructure, land and services; and appropriate banking and credit policies.

The Financial Assistance Policy program, introduced to subsidize medium- and small-scale enterprises outside of the cattle industry as well as large scale mining and some services, helps Botswana develop its own businesses and attracts foreign investment through tax holidays, unskilled labor grants, capital grants, sale augmentation grants and training grants. Government also assists the Botswana Development Corporation (BDC) which is a parastatal operating as a holding company. The BDC's industrial involvement includes operations in flour milling, drinks/breweries, cement, saw milling, forestry, sugar packaging and textiles. All of these have important implications for employment. The mode of operation for the BDC is to provide initial equity capital or in some cases direct lending to new ventures; the ultimate goal is to divest holdings to the private sector. The Botswana Enterprise Development Unit (BEDU) is likewise a parastatal focused on small-scale, indigenous ventures such as wood working, metal working, and activities related to rural industrialization.

Despite its rapid growth, the manufacturing sector is still in its infancy. Some 15 percent of value added in manufacturing is produced in small, informal village units. The formal manufacturing sector, comprising units with 10 or more workers, is heavily influenced by livestock processing related to the BMC. The rapid growth has benefited from trade agreements with other countries in the region, including SACU and bilateral agreements with Zimbabwe and Malawi.

2.E. Price Regulation

The Control of Goods Act (1973) has legal control over prices of all goods transacted in Botswana. This control is available directly or indirectly through controls which affect retail margins, producer prices, and in some cases retail prices. The Price Control Unit in the Ministry of Commerce and Industry has the power to regulate such prices. The Act provides a framework for establishing specific trading margins which are expected to be added to the ex-factory prices or landed costs of imports so that appropriate retail prices are determined. Such margins are applicable to the distributor/wholesaler/sales agent and to the retailer of all goods sold within the country, except for: soap, sugar, flour, and petroleum. Given limits in manpower to administer this Act, the mark-up controls are considered mostly irrelevant. Rather, retail prices are primarily set by competitive forces. In a step to reduce and eventually eliminate retail margins, Government is considering narrowing the mark-up controls to six essential commodities: mealie meal, sorghum, flour, sugar, meat and milk.

Government sets producer prices for soap, sugar and flour since it has conveyed monopoly power to manufacturers of these goods. The producer prices are equivalent to the South African retail price of these goods plus associated transportation costs in reaching the Botswana market. Retail prices for these goods, however, are not subject to any controls. The Botswana Agricultural Marketing Board sets producer prices and guarantees the purchase of all surplus production of foodgrains and other crops. Producer prices are established on the basis of landed costs of imports from South Africa and associated transport costs. Retail prices for gasoline, gas oil and kerosene are controlled by the Government; five petroleum companies distribute products in Botswana. Provision is made for a differential in retail price to reflect various locations in the country where products are eventually sold. Prices of meat products and agricultural goods are influenced by the operations of the Botswana Meat Commission and the Agricultural Marketing Board (the nation's sole purchaser, importer and marketer of commercial crops).

Inflation in Botswana is affected by several factors, including prices in South Africa, domestic producer price policy, the pula/rand exchange rate policy, and public wage and incomes policy. Imports comprise approximately 55 percent of nominal GDP in Botswana, with some three fourths coming from South Africa (and some 50 percent actually originating in South Africa, the remainder having been producer elsewhere). This means that inflation in South Africa is transmitted through to Botswana via the prices of such imports. Also both agricultural and industrial producer prices in Botswana have base prices related to the ex-factor prices of comparable goods produced in South Africa. The Government's exchange rate policy has mitigated the degree of inflation imported from South Africa by allowing the pula to appreciate relative to the rand.

2.F. Fiscal Policies

Botswana has consistently followed a sound fiscal policy, reflected in effective control of public expenditures and efficient use of public investment to construct necessary infrastructure for economic development. The total of current and capital expenditures, including net lending, has been kept close to the level of current revenue, with remaining moderate deficits covered by external grants and loans. Thus, the Government has not had to use financing from the domestic banking system to cover resource mobilization. The major problems in the fiscal area are to adjust expenditures to sharply varying levels of receipts, meaning the ability to maintain a steadily growing economy using a counter-cyclical fiscal policy to help offset fluctuating export earnings and recurrent droughts.

Government revenues have been high, approaching 40 percent of GDP, stemming from mineral revenue and Customs Union receipts (which combined are over half of total revenue). Relative to expenditure levels there has not been a shortage of revenue. However, the need for major programs to diversify the economy mean that in the future there may be need for greater revenue through a higher tax ratio. Also taxes will need to be used to address issues of income distribution and resource allocation. In a situation where excise taxes and import tariffs are limited by membership in SACU, non-mineral income taxation is the only potential area for effective tax policy.

2.G. Financial Sector Policies

Botswana established its own independent monetary control in 1975 when it withdrew from the Rand Monetary Area and established its own central bank, the Bank of Botswana, and its own currency, the pula. However, membership in SACU and unrestricted movement of capital to and from South Africa, especially through foreign companies operating in Botswana, means that monetary policy must be conducted with close consideration of events in South Africa. Generally Government has conducted a cautious monetary policy to maintain a stable exchange rate and to keep domestic inflation under control.

A significant aspect of the banking system is the fact that Government is a net supplier of funds to the banking sector, rather than borrowing from it since late 1981 when the Government stopped issuing Treasury Bills. The bulk of Government deposits are held with the Bank of Botswana. The private sector has also been a net supplier of funds. This has created a problem of excess liquidity and with difficulties in increasing lending commercial banks have refused some large deposits. In this situation the Bank of Botswana has had to serve as a deposit-

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taker of last resort. The actual liquidity of the banking system has often been two to three times the required level.

Foreign trade largely determines monetary policy. Prior to 1981 foreign reserves were increasing as diamond exports rose, causing a problem of excess liquidity. After mid-1980 bank loans and advances increased rapidly due to a construction boom associated with the Jwaneng diamond mine; domestic liquidity as a result gradually tightened. When foreign exchange earnings and reserves started to fall in mid-1981 with a slump in diamond exports and rising imports, the Government had to introduce a stabilization package in 1982. This package cut planned government expenditures and sought to limit expansion of bank lending by using increases in interest rates, ceilings on bank credit and an increase in the reserve requirements of commercial banks. This policy was effective in reducing total demand and expansion of imports so that after mid-1983 monetary policy could be gradually relaxed as the balance of payments situation improved and both inflation and interest rates moderated.

Interest rate policy has been key to monetary policy in spite of the fact that the Bank of Botswana has had to maintain interest rate differentials with South Africa within a narrow margin so as not to distort trade and capital flows. In 1984 interest rate differentials rose sharply due to increases in South Africa, but a capital flow out of Botswana did not occur because of the strength of the pula relative to the rand, lower inflation in Botswana, and effective control of capital transfers. For a long period of time in Botswana have been below domestic inflation rates, providing a negative return on deposits. In spite of such a low interest rate structure, banks could not find investors willing to use the large volume of funds being generated by the mining sector.

2.H. Other Policies

Mining is the predominant economic activity and has stimulated rapid growth in the past 15 years. Since 1980 it has accounted for over 50 percent of GDP and 70 percent of exports. Thus, mining trends largely determine changes in real GDP. Diamond production is the primary mining activity, comprising 88 percent of total mining output in value terms since the Jwaneng mine was opened in 1982. During 1981-85 there was a world slump in the diamond market. Botswana stockpiled its surplus production in domestically held stocks, which it was able to start selling off during 1985/86 when the world market recovered. The other important minerals are copper/nickel matte and coal, comprising 11 percent and 1 percent of total mining output in value terms. As a capital intensive activity, it provides less than 7 percent of total formal employment in Botswana.

The main contribution of mining to the economy involves the supply of large amounts of foreign exchange. But such surpluses, based on the experience of other countries, can easily lead to "growth without development" unless managed properly. Large mineral earnings can lead to pressure on Government to increase development spending rapidly, excessive expansion in the credit base and money supply, demand for wage increases, and an overvalued exchange rate. Botswana has done a good job of avoiding these problems through sound macro management. The more fundamental challenge is to use for broader based development the resources which it has and is accumulating.

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Export Enterprise Support (EES) Project

Annex J:

LESOTHO:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

Lesotho is completely surrounded by South Africa, being a small, mountains "island" within the surrounding powerful economy of South Africa. The economic base is limited, built upon a few natural resources. Land for agriculture, people, and abundant water resources comprise the economic base. A Lesotho Highlands Water Project (LHWP) is a major development project intended to capture and store water for export to South Africa, estimated to cost U.S. $1.5 billion (at 1985 prices). This will be a major stimulus to the economy, with possibility for considerable linkages and opportunities for subsidiary services and economic activities.

Agriculture (including animal husbandry) is basic to the economy, affecting the incomes and employment of 60-70 percent of the households and generating one fifth of GDP and nearly 60 percent of total merchandise exports. But possibilities for further development of agriculture are limited by: a scarcity of arable land (only 13 percent of the total land area is cultivable); low farming productivity due to poor quality land and the marginal economic returns available to labor compared to off-farm and ex-country employment alternatives; an ill-suited land tenure system; extensive soil erosion partly deriving from the land tenure system and resulting overgrazing; and uncertain climatic conditions.

Lesotho's industrial base is narrow, being limited by a small domestic market. There is heavy dependence on imported raw materials and other inputs, while poorly skilled manpower hinders expansion and productivity. These all contribute to making difficult the task of securing additional export markets as an outlet for increased production of manufactured goods.

A major source of economic activity involves the remittances from Basotho migrant labor in South Africa, confined primarily to work in gold and coal mining. Such remittances constitute nearly half of GNP and are ten times export earnings. But there is considerable uncertainty about the stability of this activity given the economic and political situation in South Africa. Unemployment is a growing problem and concern, linked partly to

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the uncertainty and stagnant demand in South Africa for additional labor and related to the limited absorptive capacity of Lesotho's formal domestic economy for additional labor. Given a population growth rate of some 2.6 percent and some 20,000 new entrants to the labor force each year, domestic job creation is estimated to be able to accommodate only approximately 10 percent of this increase each year. Thus strategies to create productive employment opportunities is perhaps the most significant challenge in the economy.

Close links to South Africa derive from the geographical location of Lesotho and institution arrangements in place. The country is a member of the South African Customs Union (SACU) and the Common Monetary Area (CMA). Its currency, the loti, is pegged at a par of one to one with the South African rand. The free exchange system allows for current payments and transfers on international transactions. The result is a very narrow ability to conduct macroeconomic policies, especially monetary and external policies. The economy is porous, as goods are readily available from abroad, goods and financial resources capable of moving across the border, and the economic conditions in South Africa determinant in establishing economic aggregates in Lesotho. With large import requirements for consumption and capital goods and relatively low exports, there is a requirement of investment and assistance inflows, requiring maintenance of economic policies and conditions conducive to foreign investment and support. Economic management predominately relates to adjusting key price variables such as the interest rate and minimum agricultural prices to developments in South Africa, as well as managing fiscal operations.

Government revenues are highly dependent, over half, upon SACU receipts, over which Lesotho has no control and which are received with a two-year lag. Supplemental revenues from the domestic revenue base are very limited with large cyclic swings related to changes in migrant workers' remittances and other economic and political changes in South Africa. Expenditures for recurrent needs are growing as social projects move from capital construction to operation and unemployment as well as other social problems put pressure on Government to increase programs. Some parastatals are also creating budgetary pressure for additional subsidies to offset operating losses and capital costs.

By far the most significant capital project is the Lesotho Highlands Water Project. It will export water to the Johannesburg and Witwatersrand area while generating electricity and providing irrigation for Lesotho. Secondary activities such as services, secondary industry, fishing and tourism will also bring benefits. Employment during the construction phases as well as related to the maintenance and secondary economic activities of the project will contribute to easing the unemployment problem. South Africa will finance the capital costs of the water transfer part of the project while Lesotho must raise funds for the hydropower component. Royalties from water delivery should begin in 1997 but prior returns in the form of SACU rebates on project-related imports totaling some US$75-100 million should become available as early as 1991 or 1992. Thus, there is an imminent need to assure that revenues are put to best use to generate long-term development in the country. This will be part of a need to strengthen public expenditure planning and monitoring.

The external sector relies heavily upon migrant workers' remittances while export earnings are small and imports very high. There was a rapid growth of debt during the early 1980s so that the external debt burden has doubled. Positioning the country for a more viable balance of payments requires expansion and diversification of export earnings, reduction in the rate of growth of consumer imports, and limitation on non-concessional foreign borrowing.

During the early 1980s Lesotho's economy contracted, due to a drought-related setback in agriculture in 1982 and a sharp shock in 1983 deriving from closure of the diamond mine and completion of some large construction projects. There was a temporary recovery in 1984 where GDP grew at 9 percent, but since then its growth has been only modest, averaging 2.9 percent during 1985-87 in the face of a 2.6 percent population growth rate. Stimulated by a sharp increase in the early 1980s, workers' remittances outpaced GDP, but since 1984 nominal GDP has exceeded remittances. This has meant that real growth of GNP has lagged behind that of GDP. But in 1987, with remittances rising sharply, real GNP grew at nearly twice that of GDP. On a per capita basis real GNP declined by 1.5 percent from 1982 to 1987 while real GDP has risen by less than 1 percent.

Lesotho's current development strategy is contained in the Fourth Five-Year Plan for 1986/87 - 1990/91. Paramount is an improvement of the living conditions of Lesotho's people through employment generation and more equitable income distribution. Real GDP is projected to grow at an average annual rate of 3-4 percent over the plan period, thus making modest gains in outstripping population growth and raising per capita income levels. The strategy for achieving this growth rate is an increase in private sector investment, foreign and domestic, with the public sector providing necessary infrastructure and market-oriented incentives to raise productivity and increase output. Considerable emphasis is placed on rural employment creation through labor-intensive agricultural development programs, as well as increases in productivity of agricultural and livestock activities. Promotion of horticulture and food-grain crops is targeted to reduce imports and stimulate export-oriented production. Promotion of industries based upon domestic resources and using available labor for assembly-type operations of imported inputs is intended to promote growth in the manufacturing sector. Development of tourism and other services related to the LHWP should also generate employment and foreign exchange savings/earnings.

Within the very limited flexibility of macroeconomic policy determination open to Lesotho, the Government has undertaken a series of corrective structural adjustment measures which should lead to a more viable foundation for sustainable economic growth. Working with the IMF and the World Bank, a macroeconomic program with supporting policy measures has been developed and articulated in a Policy Framework Paper for the years 1988/89-1990/91. This program requires that Government reduce its consumption growth while assuring that the private sector respond with higher domestic and foreign investment in efficient production activity generating adequate employment opportunities to moderate the unemployment problem. This is undertaken in the face of considerable uncertainty about events in South Africa, whose change inevitably will affect Lesotho.

The 3 year period will see Government undertake to restore and sustain domestic economic growth, expand employment, raise living standards, and strengthen the nation's fiscal and external payments positions. The target growth rate of GDP is 4 percent in real terms compared with a population growth rate of 2.6 percent. Gross domestic investment is targeted to grow by 18.8 percent of GNP during this period, with a substantial increase in the proportion of investment financed by national savings. The external current account deficit, standing at 6 percent of GNP in 1987/88, is scheduled to drop to 3 percent byu 1990/91. To achieve this imports are projected to increase by 1 percent per year in real terms while imports of intermediate and capital goods are to grow as a proportion of total imports in support of investment and production targets. Imports of consumer goods are expected to decline, in relation to stagnant remittances, import substitution in agriculture and manufacturing, and appropriate monetary and fiscal measures to dampen demand for imports. Export volume is projected to grow by 10 percent each year, building upon recent investment in light manufacturing, export-oriented enterprises and Government plans to encourage investment in export opportunities. The Government will have to reduce its overall deficit from 19 percent of GDP (10 percent of GNP) in 1987/88 to 2.5 percent of GDP (1.4 percent of GNP)by 1992/93.

Unless progress is made on this agenda of structural adjustment, Lesotho is likely to continue on its past path of slow economic growth coupled with continued degradation of the resource base. Without hope of increased employment of citizens in South African mines in increasing numbers, half of GNP cannot grow in real terms. This shifts growth opportunities to expanding domestic output, with all of the challenges and difficulties outlined here.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

Lesotho is part of the Common Monetary Area (CMA), which also includes South Africa and Swaziland. The April 1, 1986 Trilateral Monetary Agreement specifies that there be no restrictions to payments within the CMA and Lesotho applies exchange controls similar to those of South Africa and Swaziland for payments to countries outside of the CMA. The currency unit is the loti (plural is maloti) which is pegged to the South African rand at a 1 to 1 par. Under the CMA agreement the rand is legal tender in Lestho as is the loti. Exchange rates for the U.S. dollar are based on the floating middle rate of the South African rand against the U.S. dollar. There are no taxes or subsidies on sales or purchases of foreign exchange. In September, 1985 Lesotho along with South Africa reintroduced a dual exchange rate system discontinued in February, 1983. This provided that local sales proceeds of CMA securities and other investments owned by non-CMA residents could not be transferred in foreign currency, but rather had to be retained as "financial rand" balances. Such balances can be transferred among non-residents at a freely determined exchange rate, thus establishing a multiple currency practice applicable to capital transactions. For other transactions the Central Bank, which controls all external currency transactions, has delegated authority to approve certain types of current payments to selected commercial banks.

The fixed monetary relationship of the loti to the rand has provided stability and policy discipline, a benefit which must be considered as Lesotho considers options regarding the links between its currency and South Africa. With the very heavyweight of South Africa in Lesotho's trade basket, the real effective exchange rate has depreciated only slightly in the past few years despite substantial nominal depreciation. But given the country's debt which is mostly denominated in non-rand currencies, the nominal depreciation has brought about a large increase in debt servicing requirements, which by the end of 1986 stood at 3 percent of earnings from exports of goods and services and 26 percent of earnings from goods and non-factor services. With great uncertainty about the political and economic situation in South Africa, this is a fragile base from which to operate external borrowing.

2.B. Import Administration

Imports consist of approximately 60 percent consumer goods and the remainder made up of intermediate and capital goods, with some 95 percent of all imports coming from South Africa. As a member of the Southern African Customs Union, along with Botswana, Swaziland and South Africa, Lesotho does not impose import restrictions on goods originating in any part of the customs union. Goods imported from South Africa do not require import licenses and include an unknown quantity of goods originating outside the customs union. Where goods are imported from outside of countries in the customs union, they usually require import licenses conforming to South Africa's import regulations. Import licenses are valid for all countries and entitle the holder to buy the foreign exchange required to make import payments. Lesotho has no bilateral payments arrangements.

2.C. Export Policies

The composition of exports has changed dramatically since 1982. In the past diamonds constituted Lesotho's main exports, but with closure of the principal diamond mine in 1982 the share of diamonds dropped from 40 percent to approximately 3 percent of export receipts. The principal export is now livestock products (mostly wool and mohair) which has risen from 13 percent of export earnings in 1982 to 44 percent during 1983-86. Exports of manufactures, consisting primarily of clothing, textiles, footwear and chemical goods,rose from 37 percent in 1982 to 39 percent in 1983-86. With the decrease of diamond exports the direction of export trade shifted from Europe where some 60 percent of exports used to go with the remaining 40 percent destined for sale within the SACU. Currently Europe receives about 10 percent of exports, while the SACU countries, predominately South Africa, receive nearly 87 percent.

Some exports are subject to licensing, mainly for revenue purposes. In practice this procedure applies only to exports of diamonds. Most exports are shipped without license to or through South Africa. To promote an expansion and diversification of exports, the Government established in 1987 an export financing scheme. This was intended to become operational at the beginning of the 1988/89 fiscal year. Administered by the Central Bank, it covers short-term (3 to 13 months) credit extended by banks to the export sector, for which the Central Bank provides a refinancing facility. Some risk will remain with the commercial banks, but predominately the Central Bank will bear the major risk, thus stimulating an increase in credit for export producers.

2.D. Industrial Policies

Agro-industries dominate manufacturing, including milling, brewery operations, fruit and vegetable canning, and leather and jute bag production. Other important industries include textile and clothing manufacturing, light engineering, and handicrafts. This sector has been the most dynamic contributor to the economy, with its share rising from 6 percent in 1982 to nearly 11 percent presently. Capacity utilization has been near three quarters in recent years and employment generated by manufacturing industries has rose at an average annual rate of 14 percent from 1980-85 as compared to 7 percent from 1974-80. But these figures mask the fact that the industrial base is very small, less than 5 percent of GNP in 1985 and only 8,700 jobs out of 65,000 jobs in the domestic formal sector. Thus, industrial development and job creation even at rapid growth rates will only make small contributions to the overall need for growth and employment. In addition, numerous problems hinder this process, including lack of entrepreneurship, scarcity of credit, and need for foreign investment capital.

A major objective in industrial policy has been diversification of the industrial base to promote large use of local materials and labor. Two public enterprises, the Lesotho National Development Corporation (LNDC) and the Basotho Enterprises Development Corporation (BEDCO) have been used to actively promote industrial development. The LNDC promotes and sometimes participates in large-scale investments, usually structured around foreign capital, using a tax holiday currently available up to 10 years or generous tax allowances, training grants, subsidized loans and industrial site rentals. Small-scale indigenous enterprises are promoted by FEDCO through provision of finance and credit facilities, training, and marketing assistance.

Government policy is to promote industrial production which has an export orientation, including textiles, processed wool, and mohair products. It will likewise attempt to promote industries and services which generate secondary benefits from the Lesotho Highlands Water Project. A government industrial sector study concluded that there is need for a separate investment promotion unit to promote private investment and provide basic investor services. The objective would be to promote investment from South Africa and elsewhere. Scheduled to become operational during 1988/89, the promotion unit would serve as a one-stop service for investors, coordinating the work of other government agencies involved in investment approvals. Focused largely on an export promotion strategy via new investment, the Government's investment strategy is intended to optimize foreign investment while minimizing loss of government revenue. Thus, use of incentives such as tax holidays will be used carefully since they may not be the deciding factor in attracting and retaining foreign enterprises. In this connection a prior decision to lengthen tax holidays up to 10 years is to be reviewed to see if alternative incentives could lead to more effective use of resources being used to subsidize new investors.

A package of incentives and policies will continue to be offered to potential investors in import-substitution and export activities, to be supplemented by an export financing scheme for export-oriented investments. The Government intends to continue encouraging industries using raw materials (agro-industries) and assembly-type operations. With appropriate import-substitution policies and use of monetary and fiscal policies this strategy should promote industrial activity while improving the external current account.

Lesotho cannot hope to equal the industrial incentives offered in the "homelands" of South Africa. However, there are advantages to investment in the country, including a low-cost and relatively productive and reliable labor force and a location with political access to foreign markets. Some South African firms desiring to protect their export markets may be enticed to relocate in Lesotho, which should avoid mere relabeling operations but otherwise take advantage of political motivations for investing in the country.

2.E. Price Regulation

Consistent with the open nature of the economy, the only prices administered in Lesotho by the Government are utility tariffs, rents for government housing, and prices paid to farmers for the five main food crops. Price developments are closely linked to South Africa's economy since imports on a duty-paid c.i.f. basis amount to almost 75 percent of the country's GNP and South Africa accounts for some 95 percent of imports. Prices in Lesotho tend to be higher than in South Africa by a factor reflecting additional transport and handling costs and local markups.

2.F. Fiscal Policies

The exercise of responsible fiscal policy is key in an environment where monetary and exchange rate policies are severely constrained by the close links to South Africa. In this situation Government's fiscal policy objectives are to strengthen the budgetary process, raise revenue, and restrain current expenditure. During the Policy Framework Period plans call for revenue-raising measures to include: simplification of the individual income tax and adjustment of tax brackets; movement to a single tax rate for company income tax and enhanced enforcement on larger companies; expansion of the tax base to include public enterprises currently excluded; broadening the sales tax base to include public utility services; tightening tax exemptions currently granted and raising taxes on luxury items;

improvements at borders for collecting sales tax; implementation of a direct income tax on migrant miners; and greater cost recovery on government services including education, health services, and public utilities.

Expenditure control is necessary in light of the strong growth of recurrent expenditures due to major weaknesses in budgeting and planning and lack of coordination between recurrent and capital budgets. This will rest upon improved budgetary processes and expenditure controls. The restraint of current expenditures will be focused on civil service payments, early retirement of civil servants, and limits on the rate of increase of the wage and salary bill to no more than the GDP deflator. Growth of expenditure for other goods and services will also be restrained to only a small growth in nominal terms.

Public enterprises or parastatals in Lesotho include utilities and some transportation, trading, development and financial organizations. In a move to reduce and then eliminate Government subsidies for these entities a more flexible tariff policy will be considered so that rates can be adjusted as frequently as is necessary. Such charges will be adjusted upwards until the burden of all capital expenditures is transferred from the Government to enterprise budgets. Also a parastatal performance evaluation unit will be established to improve performance and constrain the tendency of parastatals to grow without proper Government oversight and approval.

2.G. Financial Sector Policies

The Central Bank of Lesotho is responsible for currency issue, administration of exchange controls, and regulation of financial institutions. As a member of the Common Monetary Area (CMA) along with South Africa and Swaziland, the country allows circulation of the South African rand as legal tender and unrestricted transfer of funds between Lesotho and South Africa, free access to South African capital and money markets by lesotho residents, and a generally uniform exchange control regime with the rest of the world.

The main instruments of monetary policy used include interest rates, liquidity and reserve ratios, and the MLAR requirement for financial institutions. Due to the linkage of the economy to South Africa, the scope and effectiveness of monetary policy as an instrument of economic management is very limited. Interest rates move broadly in line with those in South Africa. The minimum savings deposit rate and the prime lending rate are fixed by the Central Bank and have been generally lower than those in South AFrica due to the higher bank operating costs in Lesotho and a desire of monetary authorities to stimulate bank credit. Other rates are freely determined by market forces.

Lesotho's interest rates rose sharply between June, 1983 to June, 1985 when rates in South Africa increased dramatically, but have declined since that time, including a reduction in the spread between the lending and deposit rates. This has been undertaken to stimulate private sector credit. However, relatively high inflation rates have kept deposit rates negative, acting as a deterrent to domestic savings.

An independent monetary policy is severely constrained by membership in the CMA and other close ties to South Africa. It is feasible for Lesotho to increase commercial banks' use of excess liquidity for productive investments which support the Government's planned increase in absorptive capacity. The export financing scheme, recently announced, will help credit flow to productive investment and exports by reducing credit risks for commercial banks. Also Government will encourage profitable enterprises to issue commercial paper as a means of widening financial instruments. Training for small-scale industrialists is intended to reduce credit risk and improve operating efficiencies. Additional saving instruments are also under consideration, especially those targeted at migrant workers holding deposits in South Africa.

2.H. Other Policies

The single most important economic activity in Lesotho is agriculture, providing income and employment for more than 80 percent of the resident labor force. Its share of GDP is approximately 17 percent. Within the sector the share of crop production (including fruits and vegetables) in GDP declined from 7 to 5 percent while that of livestock output rose from 10 to 12 percent. Stagnant crop production has meant increasing imports of part of the country's food requirements; in 1986/87 output of main cereals covered only some 58 percent of food requirements. Agricultural development is hampered by some serious physical and sociological constraints limiting productivity and impeding the application of technological innovation. The rugged terrain, with only 13 percent suitable for cultivation, means that poor fertility and soil erosion act as limits on availability of good farmland. Where land is arable, the use of fertilizers and other inputs has been limited and irrigation has been largely unavailable, both adding up to a situation where crop production is vulnerable to weather. The relative attractiveness of income-earning opportunities in mining has reduced the appeal of domestic crop farming and the individual farmers' incentives for efficient utilization of land. With wage earnings in mining at least 8 times higher than domestic farm income opportunities, most able-bodied men seek employment in South African mines. Also the land tenure system, vesting all land in the Basotho Nation which holds it in trust by the King who delegates responsibility for its administration to local chiefs, offers few incentives for sound land management and fragments holdings into small parcels.

Agriculture is a key sector in promoting structural adjustment and achievement of adequate growth. Government's strategy for this sector, supported by multilateral and bilateral donors, is to: improve the land tenure system and grazing regulations; halt soil erosion; promote forestry development; improve marketing and distribution facilities and extension services; increase research on farming and land management systems and on new crops and disease control techniques; and more emphasis on intensive livestock development in the lowlands.

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Export Enterprise Support (EES) Project

Annex J:

MALAWI:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

Malawi is a predominately agricultural economy which is small, landlocked, and poor even by sub-Saharan Africa standards with a 1987 per capita income of US$ 174. Over 35% of GDP derives from agriculture, which is the source of most of the country's export earnings also. Export crops, which include tobacco, tea, and sugar, comprise 20% of GDP and are subject to drastic price fluctuations in world markets. Lack of direct access to the sea has meant continuing vulnerability to costly regional disruptions in transport routes through neighboring countries. A rapid population growth rate of 3.2% means that the population of 7.5 million in 1987 is stressing the land base and placing pressure on production's ability to keep pace with per capita demand.

The country maintained relatively stable financial conditions until the 1970s, achieving a real per capita income growth rate of 3% per annum until 1978 through adoption of liberal economic policies. After 1978 a combination of external shocks and domestic factors slackened the growth rate, adversely affected the balance of payments position, and introduced inflationary pressures. The result was a need for comprehensive debt rescheduling in 1982 and 1983, associated with adjustment programs and assistance from the World Bank and the IMF. The adjustment package included price liberalization which realigned key relative prices and incentives. The parastatal sector has been under realignment while domestic demand pressures were cut and domestic external financial imbalances were reduced. The result was some recovery of economic growth to a real GDP growth rate of 4% per annum during 1982-84. Post-1984 there was a significant weakening of the economy; 1985-86 witnessed a rapid deterioration of the country's external financial situation due predominately to a sharp downturn in the terms of trade. Administrative controls were introduced on foreign exchange payments for private sector imports. Inflation rose and rates of real growth declined. Severe refugee problems have stressed the nation's meager resources and fiscal imbalances have delayed planned reforms and realignment of the economy. The Government of Malawi has developed a comprehensive adjustment program as part of its macroeconomic and sector policy reforms contained in the Government's medium term development strategy.

The Government's Statement of Development Policies, 1987-1996, as well as a Policy Framework Paper done jointly with the IMF and the World Bank, are the pertinent documents describing the basic strategy. Government's approach is designed to stabilize the economy and establish the foundation for resumed economic growth despite the difficult external environment. The basic macroeconomic objectives of the strategy include: a) raising the rate of real GDP growth from 1.6% in 1988 to 4% in 1989, 4.3% in 1990, and 4.9% by 1992; and b) restoring fiscal discipline consistent with balance of payments targets and reducing the annual rate of inflation from 26% in 1987 to about 5% by 1991. To accomplish this the Government will approach structural reform and financial stabilization by reducing the fiscal deficit, using strict monetary and credit policies, and exchange rate adjustment. These policies are expected to bring aggregate demand into line with available resources. Related supply side measures will increase the flow of foreign exchange to the private sector, liberalize trade, redirect credit away from the public sector, and bring about tax reform. All of these actions should stimulate the private sector.

A sectoral strategy is also part of the medium-term development program. It provides for new investments and policy reforms in the key productive sectors to increase output. This sectoral growth strategy is grounded in increased private sector activity, improved efficiency in public sector resource management, and a greater role for market forces in resource allocation. In agriculture - Malawi's major source of growth and export earnings - there will be emphasis on more intensive and productive use of resources and greater crop diversification to help offset growing land pressures and the country's vulnerability to world price fluctuations for its narrow export base. Continuing reform and efforts at privatization of ADMARC, as well as expanding the scope of the private sector in crop marketing, will contribute to agricultural reform. For the transport sector regional problems have disrupted Malawi's traditional external routes and resulted in increased transport costs and reduced reliability in the flow of exports and imports. Development of the Northern Corridor, with the assistance of donors, should improve the transport situation.

In industry Government has set out to revive production and investment by better use of incentives for domestic and foreign investment. It will stimulate efficiency through competition introduced into the economy by eliminating quantitative restrictions and allowing in imports, and increasing the flow of credit to small-scale industry. In education Government will emphasize the expansion and improvement of primary education, enhancing scientific and technical skills and improving teacher training. Population growth and health services will be addressed by better staffing of primary health education care facilities and increased allocation of resources for maternal and child care services. Nutrition will be addressed through a food security monitoring and reporting system which will be in place by the end of 1988. Smallholder farms, with the bulk of rural households living below subsistence levels, will benefit by increased emphasis on research and extension programs.

In general, the Government's medium-term development strategy is comprehensive, integrated, and responsive to the need for liberalization of the economy. It assigns a larger role to the private sector, market pricing mechanisms and incentives. The program reinforces macroeconomic stabilization strategies initiated under an IMF stand-by arrangement. Its foundation is trade liberalization, associated exchange rate adjustment, fiscal deficit reduction, reform of foreign exchange allocation, and tax reform.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

An essential part of Malawi's Medium Term Development Strategy relates to active exchange rate management. The country pursued a flexible management of its exchange rate during the 1980s and, except for a slight appreciation in 1984 and 1985, kept the real effective exchange rate near the 1979 average level. However, adverse shifts in terms of trade, high debt servicing costs, and unbudgeted food and security-related expenditures brought about a high level of excess demand for foreign exchange starting in mid-1986. The Kwacha was devalued by 20% in February, 1987, but the effect of the depreciation was mostly offset by inflationary developments. Stringent foreign exchange rationing was therefore left in place during all of 1987. In order to restrain import demand further and stimulate export production, Government further devalued the Kwacha by 15% in January, 1988.

Government has made a commitment to pursue a flexible exchange rate policy, the aim being to maintain external competitiveness, encourage exports, and achieve balance of payments objectives. To do this Government has agreed to maintain the exchange rate such that it remains consistent with trade liberalization, tariff rationalization, and external resource availability. The World Bank will monitor the real effective exchange rate to ensure that it is consistent with the

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trade reform program it is supporting through its Industrial and Trade Policy Adjustment Credit. The IMF will have primary responsibility for negotiating exchange rate adjustments under the stand-by arrangement and an Enhanced Structural Adjustment Facility.

2.B. Import Administration

Liberalization of the trade regime is the centerpiece of Malawi's industry and trade adjustment program. The industrial sector historically developed efficiently because it grew in a relatively free-trade environment with price signals which encouraged efficient resource allocation and adequate resource mobilization. The period since 1980, but especially since 1986, has witnessed a contrary set of policy responses as Malawi reacted to exogenous shocks by closing the economy and cutting away from market clearing price signals. The role of imports in Malawi's economy is crucial since the country cannot support efficient production of all industrial goods. Imports thus complement domestic production, allow specialization, and introduce an element of competition into local monopolies. Thus the closing of the economy has encouraged excessive product diversification, inefficient import substitution, and monopolistic pricing. To move away from these distortions Malawi intends to abandon discretionary foreign exchange allocation and to lower import tariffs.

Government intends to phase out administered foreign exchange allocation and move back to a market-determined system which would allow importers to obtain foreign exchange on request. Given the existing external imbalances and low level of foreign exchange reserves, Malawi has spread the liberalization of its foreign exchange allocation system over a three year period. In the first stage, introduced in February, 1988, a range of import items comprising 25% of the total import bill was freed of prior foreign exchange allocation approval, including such key items as fertilizer, petroleum and 25% of raw materials and spare parts. In the second stage some 30% of the import bill will be similarly liberalized, so that it will include 50% of raw materials and spare parts and some finished goods to introduce competition through imports into the domestic market. In the third stage the remaining raw materials and spare parts will be liberalized, followed by most intermediate and capital goods. By this stage approximately 75% of the total import bill will have been freed of administrative rationing. Government further plans eventually to liberalize remaining imports, mostly consumer goods, by mid-1991. In consultation with the IMF and the World Bank, Government will review resource availability and adjust liberalization of imports and resources so that they support each other.

Along with elimination of prior Reserve Bank exchange approval for imports, Government intends to liberalize import licensing. This will be done by expanding the Open General License (OGL) System. Currently about 85% of the total import bill is subject to OGL, with 34 specific categories of goods and all goods from certain countries subject to import licenses from the Ministry of Trade, Industry and Tourism. Government is eliminating this import licensing requirement from 8 categories of goods and 22 countries of origin. The few remaining licensing requirements pertain primarily to issues of public health, safety, or security.

2.C. Export Policies

Additional generation of foreign exchange through exports is essential to the longer-term viability of Malawi's liberalization strategy. While initial donor assistance in resource flows will supplement current foreign exchange resources, such exceptional balance of payments financing will not be available beyond the adjustment period. Growth of the economy in the future thus rests on expansion and diversification of Malawi's export base. To assure that this happens Government has adopted a new strategy to enhance the competitiveness of Malawi's exports in world markets and encourage non-traditional export activity.

The flexible foreign exchange rate policy described above is by far the most important component of such a strategy, since it assures that successful exporters are rewarded appropriately in domestic Kwacha terms, at the scarcity value of the foreign exchange they earn. This removes the anti-export bias inherent in an overvalued currency, which rewards those who can import at artificially low costs of foreign exchange and punishes exporters by paying them less in domestic currency terms than their foreign exchange is worth.

Government is also committed to streamlining administrative procedures for exporters. Currently the Ministry of Trade, Industry and Tourism subjects 20 goods to licensing, including tea and tobacco which are the two largest export earners. Such licensing has been based upon the rationale of either quality control, national food security, or environmental protection. Government is committed to eliminating these licensing requirements for almost all export goods which are not needed for food security. Plans exist for a World Bank Agriculture Sector Credit during 1990 which will assist in developing simplified mechanisms for ensuring export quality control, thus reducing the role for export licensing further.

Fiscal incentives to exporters are also being increased as part of Malawi's tax reform program. Exporters are currently eligible for import duty drawbacks on imported inputs used in export production. The mechanism has been cumbersome and difficult to operate. Exporters have in actuality received back, in aggregate terms, less than 2% of total import duties in 1985 and those which did receive rebates were subjected to very long delays. Government is introducing a simplified drawback scheme which will eliminate physical content requirement, expand eligibility criteria, and provide uniform rebate rates by sector of production. An income tax allowance is another incentive being introduced for exporters. All registered exporters will receive back an income tax allowance of 4% of their taxable income derived from export sales.

A Foreign Exchange Revolving Fund has been established by Government to assure that exporters have adequate access to foreign exchange for their import requirements during the initial stages of the liberalization program. The purpose of the Fund is to make foreign exchange readily available to eligible exporters to import raw materials, intermediate goods and packaging goods to meet export orders. An Export Promotion Council of Malawi, established by the Export Promotion Council Act, will also offer other help and technical assistance to exporters.

2.D. Industrial Policies

An Industrial Development Act allows Government to control investment in the industrial sector. Investors are required to obtain an industrial license before making any investment in the manufacturing sector. This mechanism grants Government the power to hinder competition with existing producers, a power which has not typically been used. The law also includes a provision whereby certain producers may be granted exclusive monopoly rights for a period of five years. Again this power has rarely been used, but it acts as a potential deterrent to investors. As part of the liberalization of Malawi's economy, Government has agreed to revise the Industrial Development Act to eliminate the exclusive monopoly rights clause and strengthen domestic competition.

2.E. Price Regulation

Government previously decontrolled prices on more than 50 goods as part of its program to improve the efficiency of resource allocation and the structure of incentives, with the support of World Bank loans SAL II and SAL III. Price controls remain on 5 critical or politically sensitive goods: low-grade meat, fertilizer, fuel, sugar, and vehicle spare parts. As part of the Government's liberalization efforts there will be a de-control of the price of low-grade meat and possibly automobile spare parts. Government will adjust domestic prices of petroleum products periodically to implement a full pass-through of import and domestic distribution costs. Fertilizer and sugar prices will be reviewed under the up-coming Agriculture Sector Credit starting in 1990.

2.F. Fiscal Policies

Achievement of the broad program of liberalization undertaken by Malawi requires stringent controls of Government expenditures and attention to raising tax revenues. Without such measures, trade and industry liberalization are threatened by inflationary pressures, excessive demand for imports, and undue pressures on the exchange rate. Government's goal is to reduce the fiscal deficit to a level that can be financed while leaving domestic credit robust for investment. Taxes are relatively high in Malawi (the tax revenue to GDP ratio is near 20% and higher for the modern sector) so that most deficit reduction must fall upon expenditure adjustment (with Government expenditures to GDP projected to decrease from 28.4% in 1987/88 to 26.3% in 1990/91). During the same time period the revenue to GDP ratio will remain relatively constant, at about 18.7% of GDP.

The fiscal balance will be monitored by the IMF under terms of the stand-by arrangement and the proposed Enhanced Structural Adjustment Facility (ESAF). A balance will have to be continually drawn between expenditure targets on the one hand and resource flows from tax revenue and available foreign concessional inflows on the other hand. To tighten expenditures institutional measures will be developed to strengthen preparation of budgets for key development sectors and improved information flows will allow for tighter expenditure control. Among other reforms there will be a rolling three-year public sector investment program.

A comprehensive reform of the tax system will also be undertaken to improve its equity and efficiency. Between 1966 and 1981 Malawi raised its tax collection ratio from 8.6% of GDP to 15.4%, approaching tax levels as a proportion of GDP found in countries with per capita incomes 3 to 4 times higher than Malawi's income level. A large share of the increase in tax generation came from higher burdens placed on international trade taxes, which rose from 35% of total tax revenue in the early 1970s to 46% in the early 1980s. The average tariff rate on private sector imports increased from 12% in 1975 to 32% in 1986. This stimulates import substitution while acting as a disincentive to exports. There are also weak investment incentives in the corporate income tax, a cumbersome system of domestic surtax exemption, inefficient tax administration, and some tax leakages from the system.

Based upon work done under a 1985 World Bank report: "Tax Policy in Malawi," as well as several tax consultant missions from the Harvard Institute for International Development, Government has developed a package of tax reforms to be implemented during the period 1988-90. These reforms will shift the burden of taxation to domestic transactions and away from international trade, as well as to consumption and away from production. Of special relevance to the trade and industry sector, commodity taxation will be moved away from the present system of import duties, levy, surtax and excise tax and towards a flat basic rate of taxation on all imports and domestically manufactured goods. This tax will be collected at the point of importation or ex factory. Exports will be exempt under this system.

2.G. Financial Sector Policies

Government has agreed with the IMF to pursue a tight monetary and credit policy. This is intended to strengthen the balance of payments, reduce domestic inflation (from approximately 26% in 1987 to a target of 5% in 1991), and to provide the private sector with sufficient resources to finance expansion requirements. Under the present system there are no administrative controls which direct credit within the economy and interest rates are market-determined. Government will set credit ceilings consistent with IMF targets. In the institutional realm Government has agreed to update and strengthen the financial system's legal framework and Government supervision of financial institutions. It has also agreed to improve mobilization of domestic long-term funds and make credit more readily available to small-scale industry.

2.H. Other Policies

Associated with the above reforms affecting the trade and industry sector, Government has undertaken to stimulate off-farm small-scale industry. Such economic activity has been limited in its development by lack of access to financing for working capital and limited entrepreneurial experience. The current level of small-scale (fewer than 20 workers) industrial establishments stands at 156 registered firms employing a total of 1,370 people. Government intends to strengthen existing financial and technical assistance institutions to small-scale industry and channel more credit to the sector. Donor assistance is available to assist in this undertaking. While such firms are not likely to develop as exporters immediately, stimulation of small-scale private enterprises will improve employment prospects and serve as a training ground for skills and entrepreneurial talent. Once stimulated, there is considerable room for this sector to develop niches in the export sector as well as in production of efficient domestic inputs to production for export.

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Export Enterprise Support (EES) Project

Annex J:

MOZAMBIQUE:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

During the first half of the 1980s the Mozambican economy suffered severe declines in output and economic disturbances. Some of this can be attributed to external forces including adverse terms of trade and armed attacks throughout the country. But inappropriate economic policies also contributed to the problems. An initial effort was made to adopt corrective policy measures during 1984-86. This included debt rescheduling, creation of an export retention scheme, adjustments in prices controlled by Government, and initial freeing of some farm produce prices. Since these actions did not attack the fundamental structural problems and distortions, they proved insufficient and the economy continued to shrink. Government recognized that the bleak security situation, while burdening the economy and distorting economic activity, was not the sole reason for economic collapse. What was evident was the need for a much more comprehensive and ambitious reform of the economy.

In January, 1987 the Government undertook an Economic Rehabilitation Program designed to relieve structural problems and distortions. Increased efficiency in production and resource allocation was one goal, pursued by greater reliance on market signals and reduced central administrative controls. Demand management was also pursued through the use of fiscal, monetary, exchange rate and external borrowing policies. Resources were sought from an increase in and a redirection of external assistance, part of which was to be used to rehabilitate economic infrastructure and to ease the situation of people displaced by drought and security disturbances. External debt was to be serviced at feasible levels. Structural reforms were started in agriculture, industry, banking and transportation while public enterprise management was to be improved.

The most recent Government statement of overall macroeconomic policy strategy, jointly prepared with the IMF and the World Bank, is the second Policy Framework Paper document covering 1988 to 1990. It reaffirms the basic strategy of the Economic Rehabilitation Program.

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As overall objectives for the Economic Rehabilitation Program, the following remain of highest priority:

1) reverse the decline in production and restore a minimal level of consumption and income for the population, especially those in the rural areas;
2) curtail domestic financial imbalances and strengthen the external payments position;
3) establish the conditions for more rapid and more efficient economic growth in the medium- to long-term as the security situation eases and other exogenous constraints improve.

These add up to modest economic growth being re-established during 1987 and accelerating to a growth rate of 3-4% during 1988 and 1989. Recovery is to be centered on the agricultural sector which can provide the needed increases in rural incomes and restoration of production for export. Export volumes are projected to grow at 8%, although starting from a very low base. Real investment would stabilize with a redistribution of available resources to rehabilitation and completion of priority ongoing projects rather than initiation of new projects. Recovery of production and external financing of essential imports should provide for a relatively rapid growth in real consumption per capita averaging in excess of 5% per year.

This reform approach should be put in some historical context so that it can be judged in terms of its effectiveness in correcting economic problems and policies. Mozambique's economy went through a serious decline in output and aggravation of economic distortions and financial imbalances during the first half of the 1980s. Exogenous developments, including adverse terms of trade and climatic variation, were adverse during this time while disruptions and insecurity from armed attacks in a number of parts of the country introduced severe dislocation. At the same time, economic policies were inappropriate to deal effectively with an increasing range of economic problems.

From 1980 to 1986 overall production decreased by nearly 30% while exports dropped by 75% and imports fell some 33% by the end of 1985, only recovering slightly in 1986. An increasingly overvalued exchange rate aggravated external imbalances and external debt service arrears rose rapidly. Large fiscal deficits and unchecked bank financing of enterprise losses resulted in a tripling of the money stock despite shrinking real output. Extensive administrative controls permeated the economy, including direct decisions on prices and resource allocation. Although intended to promote efficiency and social equity, such government control of the economy brought about rigidities and disincentives which worked against economic recovery. Distortions increased as barter, inflation and parallel or illegal markets became pervasive.

Initial, although modest, efforts were made to correct these economic problems during the period 1984-86. External debt was rescheduled. An export retention scheme was introduced. Prices were adjusted upwards for some staple food items and services while there was a freeing of some farm produce prices. But these measures did not attack the basic structural problems and distortions in the economy and proved to be insufficient to reverse the economy's decline. In light of the probable continuation of a serious security threat to the country, which would present additional disruptions and hamper economic recovery, a bolder, more comprehensive reform program was obviously required. The Economic Rehabilitation Program which started in January, 1987 is that comprehensive attack on structural rigidities and distortions in the economy.

The first year of the Economic Rehabilitation Program, in summary terms, sought to enhance economic efficiency and improved resource allocation by strengthening economic incentives and increasing reliance on market signals as opposed to centralized administrative controls. Other measures sought to improve demand management by using appropriate fiscal, monetary, exchange rate and external borrowing policies. External assistance was increased and redirected to support rehabilitation of economic infrastructure for the population displaced by drought and security disturbances. External debt burden was rearranged and debt service payments arranged at feasible levels. Structural reforms were started in the key sectors of agriculture, industry, banking and transportation.

During the second year of the Economic Rehabilitation Program - 1988 - the overall objectives remain unchanged. The strategy is to continue a focus on key constraints to economic growth while refining particular policy changes and new programs to take account of various economic studies completed during 1987. Further work will be done in 1988 to chart out a multi-year rehabilitation of various sectors of the economy, consistent with the evolving macroeconomic framework of increasingly price-based incentives and indirect as opposed to previously direct government controls on the economy.

Mozambique has undertaken an ambitious, if high-risk, economic reform package. It has made substantial progress towards correcting market distortions, dismantling direct administrative intervention in the economy, and re-establishing a foundation from which economic growth can be sustainable. However, the economy was severely deteriorated when the current reform effort started, both from a long period of excessive statist control and from security disruptions which continue.

The need for rehabilitation of most sectors of the economy places real, if unknown, constraints on a well-functioning economy over the next 5 years. Some sectors have capital so deteriorated and obsolete that it must be replaced. Other sectors, not directly as dehabilitated, nevertheless depend on inputs from an economy with major portions unable to provide reasonably priced and regularly delivered intermediate inputs to production.

In such a situation, there is a substantial risk that the reform agenda will be delayed or even set aside. Security risks, having severely disrupted the country, could remain serious or even increase. Supplemental resources from donors must remain high if the reform agenda is to continue. Political will in the nation must continue to support reform through a period when hardship will prevail and some groups' welfare will be relatively harmed as other groups' well-being increases.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

The objective of exchange rate management under the multi-year Economic Rehabilitation Program is to restore economic incentives by integrating the official and parallel market rates. This should result in a market-clearing exchange rate by the end of the Economic Rehabilitation Program period, allowing Government to rely more heavily on macro management rather than direct administrative controls to maintain the balance of payments. The goal at the start of the Economic Rehabilitation Program was to bring the official rate to 50% of the parallel market rate by the end of 1987, to 70% of the parallel rate by the middle of 1988, and to provide for a merging of the two rates by 1990.

During 1987 the metical was devalued from Mt. 39 per U.S.dollars to Mt. 200/U.S. $ in January and to Mt. 400 in June, 1987. 1988 should see a continuation of flexible adjustments in the exchange rate, a policy central to restoring adequate economic incentives (especially for exporters) and to strengthening the nation's external accounts. The Government intends to attain a realistic and flexibly managed exchange rate by the end of the Economic Rehabilitation Program period (1990). This should allow for a dramatic decrease in the scope of administrative allocations of foreign exchange and interference in the trade system. The objective is to use appropriate macroeconomic policies to manage the balance of payments.

Some progress in this regard has already been achieved. It is Government policy initially to prevent (on a monthly basis) a widening of the gap between the official and the parallel market foreign exchange rates. A modified system of exchange rate management will be developed during 1988 to move the exchange rate by 1990 to a realistic market-clearing level.

2.B. Import Administration

Linked to exchange rate policy, and the move towards a more flexible and realistic exchange rate, will be a gradual dismantling of direct Government control of the trade system. In the interim, through 1990, there will still be dependence on administrative allocation which will be improved in efficiency even as the economy's need for such direct allocation shrinks. For example, the Government has decreased the number of product groups which must be traded through a Government monopoly trading corporation from 11 imports and 3 exports at the end of 1986 to 5 imports (petroleum products, pharmaceutical, agrochemicals, cereals, and electricity) and 1 export product (sugar) by the end of 1987. During 1988 the Government is committed to review the role of administrative import restrictions in the economy and prepare a program under which a limited number of products could be imported without administrative restriction. Due to be implemented by late 1988, such a system would allow importers of such products to purchase foreign exchange through the banking system subject only to automatic licensing procedures.

Steps are being taken to improve the operation and efficiency of the foreign exchange allocation system, which will decrease in importance but remain through the Economic Rehabilitation Program period. Semi-annual reviews are being made of estimated foreign exchange supply and demand. Improvements are underway to provide a better match between donor assistance and the priority needs of the economy. Allocation of foreign exchange among sectors and potential users is to rest increasingly on measures of overall efficiency of the proposed users in terms of contribution to domestic value added. There will be a broadening of the range of products which can be imported without administrative allocation. While interim detailed allocation procedures will decrease in importance, Government will continue to maintain a degree of control over aggregate foreign exchange allocation to assure that importation of essential products continues while debt service obligations are met.

Government will, at the same time, maintain the existing "own use" import system where imports are allowed in, subject only to the automatic granting of license if value exceeds US$ 500, where such imports are for an individual's or enterprise's own use and financed from outside resources (i.e. no recourse to the banking system for foreign exchange is required). Permission for resale of specific imports is to be given provided the trader

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is registered to trade in these goods, and if such goods do not compete directly with domestic industry.

2.C. Export Policies

An Export Retention Scheme was introduced in 1984 and has since then been expanded to include, by the end of 1986, nearly 100 large producers that earn foreign exchange. In January, 1987 it was further broadened to include all exporters of non-traditional products. More recent revisions have attempted to reduce discrimination by narrowing the range of retention rates for participating exporters and thereby lessening the chance of tying up scarce foreign exchange in uneconomic uses. The average retention rate was reduced from 70% during 1984-86 to 50% in 1987. Also purchases and sales of "rights to import" using foreign exchange retained under the scheme are now allowed through the banking system, but only among participants in the scheme. Additional revisions to the retention scheme are inherent in the Economic Rehabilitation Program, including automatic eligibility of exporters, a further narrowing of the range of retention rates, and an easing of restrictions on transferability of retention proceeds.

2.D. Industrial Policies

The Economic Rehabilitation Program strategy for the industrial sector is far-reaching. It includes improved efficiency of resource use and increased autonomy and accountability of enterprises. Macroeconomic policies are intended to provide increasing incentive to bring about these adjustments, while in the interim corrections in administrative systems will start the reform process. Thus, foreign exchange allocation, in the interim until a market-clearing exchange rate takes its place, will be improved. There will be credit and budgetary transfer restrictions. Increasing autonomy in trading decisions of enterprises both in domestic and international transactions will shift responsibility to production entities and make them responsible for operating efficiency and reduction of operating losses. There will be a program of price decontrol. A Review of Enterprises will review 15 major agricultural enterprises and 25 industrial operations with the goal of identifying specific strategies for their restructuring (be that rehabilitation, divestiture or closure). This review will set the tone for the types of restructuring required in other enterprises.

The strategy of the Policy Framework Paper, 1988 - 1990 related to industry builds as much upon changing stimuli in other sectors as upon changes directly affecting industry. Thus, changes in the exchange rate, pricing subsidies, managerial autonomy, credit and foreign exchange allocation are seen as critical determinants of the health of industry. Liberalization of these economic determinants will help ensure that resources increasingly are directed at the most economically efficient enterprises and sectors. In addition, greater flexibility in industrial pricing will help introduce greater supply response. The number of product groups subject to fixed pricing legislation was reduced from 9 to 7 in January 1988, with further reductions planned in June, 1988 and by the end of 1988. In the case of products remaining under control, prices will be adjusted regularly to keep pace with exchange rate adjustments. Increasingly enterprises will be allowed to adjust prices subject only to ex post ministerial review.

2.E. Price Regulation

A central element of the Economic Rehabilitation Program has been progressive dismantling of rigid pricing and allocative controls. There will be retention of limited controls for products considered strategic for security, where an equitable regional distribution is necessary, where monopolistic power can be exercised, and in relation to implementation of grant and loan conditions.

Generally pricing policy will focus on increasing flexibility in price setting throughout the economy to restore the pricing mechanism as a means of allocating resources. The reduction in the number of products subject to fixed price controls will continue; in January, 1988 it was reduced from 37 to 32 and at least 4 additional items were to be decontrolled by June, 1988 and 3 more by the end of 1988. Eventually items still price controlled should be limited to fixed prices for a few staples, which will be adjusted regularly to reflect production and procurement cost changes (especially changes in the exchange rate).

There will be substantial increases in prices of those commodities in the nation's ration system that are highly subsidized. The goal is to eliminate the gap between actual economic production costs and consumer prices, since this has operated as a distortion to increased production and marketing while placing a heavy burden on the fiscal budget.

Related to these moves, Government will expand domestic and international trade which will expand competition at all stages of the distribution system. Enterprises have been given permission to trade with other enterprises directly, rather than as previously required only through wholesaling intermediaries. Final products subject to administrative allocation dropped from 43 to 30 at the end of 1987 and there will be further reductions in 1988. Goods remaining under direct allocation will be managed with highest priority going to providing sufficient allocation to displaced persons due to security and climatic conditions and to the rural areas.

2.F. Fiscal Policies

The strategy for fiscal policy under the Economic Rehabilitation Program during 1987 focused on strengthening the revenue base, rationalizing and limiting public expenditure, and restoring financial discipline to public enterprise operations. In January, 1987 the domestic tax code was revised to widen the base of domestic taxation, accelerate payments, improve the income tax, simplify collections and increase revenue generation. The growth rate of current expenditure has been held lower than the growth rate of revenue. For capital expenditures a limit has been placed such that it can grow no faster than the level of net external financing. Public enterprise losses have been brought into the government budget for the first time while a limit has been placed on the amount of such losses and on the cost of public subsidy to consumers. There have been complex impacts on revenue and expenditure from devaluation and other relative price changes. However, during 1987 it was possible to bring about a limited reduction in the ratio of the overall deficit to total expenditures. The current government deficit as well as domestic bank financing of the overall deficit were constrained at nominal levels to an amount only slightly higher than in 1987, which means a considerable reduction in relation to other budgetary and economic aggregates.

During 1988 and later years of the Economic Rehabilitation Program fiscal policy objectives will continue to focus on a strengthening of the public sector's financial position. This will include improvement of public savings performance and a corresponding reduction of that sector's recourse to domestic bank financing. The "crowding out" effect of budgetary financing on legitimate credit demand in the rest of the economy must be reduced if economic recovery and rehabilitation are to proceed and inflation is to be constrained. Specific fiscal measures to be undertaken include: improved buoyancy and efficiency of the revenue structure; restoration of financial discipline and profitability in public enterprises; constraints on the growth of current government expenditures; prioritization of government capital expenditures; and improved coordination and utilization of external assistance.

Revenue enhancement during 1988 focuses on initiating a customs tariff reform and on preparing a package of additional domestic tax measures to strengthen the domestic revenue system. An initial round of customs tariff reform will be prepared with the objective of substantial simplification of the rate structure of import duties, which will be implemented by the end of the year. While this is intended to be roughly revenue neutral, it should improve collections. In addition, other revenue recommendations of the IMF will be considered for possible adoption during 1989. These include application of the turnover tax to imports (inclusive of import duties) similar to its current application to domestic manufactures and revision of the turnover tax rate structure so that it impacts more heavily (10%) at the manufacturer/importer level than at the wholesale/retail level (5%). This latter adjustment would limit cascading and improve collections.

An important part of constricting current government expenditures involves restrained wage policy, severe limits on purchases, and reductions in budgetary subsidies. During 1988 a major effort is to be made to reduce consumer subsidies and prevent them becoming an uncontrollable structural burden on the budget. Prices of staples which are rationed and heavily subsidized in the two main cities will be increased in price several fold while the impact on effective purchasing power of lower income families is to be substantially offset by wage increases. A better "safety net" to protect the unemployed, refugees and other vulnerable groups will be put in place with the assistance of donor support. Wage increases during the remainder of the Economic Rehabilitation Program are to be limited to no more than the anticipated increase in the cost of living. Subsidies to public enterprises will likewise be reduced and action programs prepared to correct the financial imbalances in the public enterprises with the largest losses. Capital expenditures will remain heavily dependent on external loan and grant inflows, while priority in capital expenditure will go to completion of the most productive ongoing projects, rehabilitation and maintenance expenditures,and for projects providing rapid earnings or savings of foreign exchange with high rates of economic return.

These actions should improve the current budget position and bring about a steady reduction in domestic bank financing of the overall budget deficit. During 1988 the objective is to reduce bank financing of the deficit somewhat below the 1987 level of Mt. 20 billion, which would be a sharp reduction in real terms. The Government aims to achieve a current budget surplus by 1990.

2.G. Financial Sector Policies

During 1987 money and credit policies were focused on reducing excess liquidity and improving the efficiency of credit utilization. Interest rates were raised sharply in January, 1987 from a range of 0-6% for deposits and 3-10% for loans to 3-20% for deposits and 12-35% for loans. Commercial principles were brought into the evaluation of loan requests, within the overall credit ceilings. Improvements in financial analysis, accounting and management of financial institutions was initiated. During all of 1987 expansion of money and quasi-money was limited to an estimated 50%, which was slightly over target but much less than the increase in nominal GDP.

During 1988 financial sector policies will continue to encourage structural reforms of the financial sector while constraining bank credit expansion to levels consistent with the likely flow of financial savings through the banking system and with the balance of payments and other macroeconomic objectives. Credit policy will continue to be implemented through explicit ceilings on aggregate bank credit and on credit to Government. Plans for more indirect control of credit, including use of reserve requirements, will be formulated for adoption by the end of the Economic Rehabilitation Program.

The credit program for 1988 is based upon an increase in money and quasi-money of approximately 43%, with no significant change in net foreign assets. Within this expansion net credit to Government will be limited so that there will be a substantial reduction in real terms relative to 1987. Interest rate increases are focused on bringing about positive real interest rates by the end of the Economic Rehabilitation Program period. Substantial reforms are necessary in requiring government to pay interest on borrowed money and simplification of complicated loan structures and administration.

2.H. Other Policies

Agriculture is the key sector in the country and the Economic Rehabilitation Program includes policies to reform pricing and marketing policies to provide greater incentive to both producers and traders while stimulating more efficient production and distribution. Initial efforts to free up direct controls on production centered on fruits and vegetables; experience during 1987 indicated that while nominal prices increased under decontrol when prices were allowed to move to the parallel market level, in real terms prices were significantly lower. At the same time, private sector production improved significantly in response to improved financial incentives and the reduction in controls. It is recognized that as this and other agricultural markets are cut away from direct government controls there will be a need for international assistance to improve inputs, equipment and vehicles if the producers and

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markets are to respond positively to improved incentives.

Agricultural pricing will keep pace with other aspects of decontrol as the Government reduces the number of products subject to fixed pricing and allows those still under control to adjust prices to reflect increased input costs (including a pass-through of exchange rate adjustments). Parallel with decontrol will be efforts to improve access to credit, provide rehabilitation of producer and marketing infrastructure, and stimulation of private sector participation.

Integral to success in agriculture, industry and other sectors of the economy is improvement in the transportation sector. Bottlenecks must be eliminated in moving domestic agricultural products and in providing for long distance cargo transport. Transport tariffs are to be reviewed during 1988 to improve efficiency and reduce direct administrative controls. Public transport agencies will be pushed to operate on financial criteria while efforts will be mounted to encourage private participation in road transport. Continued rehabilitation of the major rail corridors should begin to generate higher foreign exchange earnings from transit services and improved domestic trade.

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Annex J:

SWAZILAND:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

The nature of Swaziland's efforts at liberalization and economic reform are a function of its location, economic structure and organization, and exceedingly open economy. Nearly surrounded by South Africa and being a member of the Southern African Customs Union (SACU) and the Common Monetary Area (CMA) which was formerly called the Rand Monetary Area, there is a tight linkage of the country's economic performance to South Africa and little room for independent fiscal or monetary policy. The private sector plays a large role in the economy which has a strong market orientation, with prices signaling resource allocation and providing incentives for efficient production.

Membership in SACU, along with Botswana, Lesotho and South Africa, means that import tariffs and conditions are determined by South Africa, with provision for consultation among the Customs Union members. Although there is provision for tariff protection of infant industries, this has not generally been exercised by Swaziland to protect new industry. Some efforts at restriction of food imports competing with local produce have been undertaken but overall restraints on imports are minimal.

Government revenues are largely derived from a share of SACU collections, with the tariff rates and terms basically beyond Swaziland's control. Prices are tightly linked to those in South Africa due to an open border and minimal restrictions on imports and exports; inflation rates are therefore determined by events in the South African economy. This is true even though Swaziland at least nominally controls prices of many essential commodities including those under exclusive local production.

Monetary policy is similarly constrained by membership in CMA, whose other partners are Lesotho and South Africa. The South African Rand circulates freely along side of Swazi emalangeni and there are no restrictions on the movement of funds within the 3 nation RMA. The Swazi currency is the lilangeni which is completely backed by rands, rand deposits and South African government securities; all making the lilangeni freely convertible with other world currencies. This linkage to CMA makes interest rates and credit availability derive from management of the South African economy.

Given very little freedom to conduct independent macroeconomic policy, Swaziland has pursued a policy of encouraging private investment and initiative within a largely free enterprise economy, where the government is basically confined to providing public infrastructure and a suitable investment climate. The management of tax and loan policies has been used to entice private investment, both domestic and foreign. This has worked relatively well in a situation where the Swazi economy is attractive, being politically stable, open with access to foreign exchange and labor as well as the South African economy, and a "safe harbor" of sorts from the disruptions and liabilities of locating production facilities in South Africa itself.

The degree of subservience of the Swazi economy to South Africa can be seen in a number of ways. Exports are one half of GDP while imports are equivalent to two thirds of aggregate expenditure. One third of these exports go to South Africa while 80 percent of imports come from South Africa, including 100 percent of energy imports. A large and rising proportion of trade transits through South Africa. Also the number of Swazi workers in South African mines has been increasing steadily over the past 5 years, with some one third of formal sector employment in Swaziland deriving from such labor. South African investments in Swazi facilities add to the tight linkages of the two economies.

Market forces are central to both economic policies and development strategy in Swaziland. Few prices are controlled and even there prices for commodities are adjusted frequently according to market forces so that no budgetary subsidies result. Public enterprises are limited to rail, airline and public utilities, with the Government more recently adding some investments in tourism; the Government is also a minority partner in some firms, including the newly created Swaziland Industrial Development Corporation, a private company which has multilateral and bilateral agencies holding a controlling interest.

Private investment must provide the main impetus to growth over the medium term in this situation. The planning process focuses primarily on provision of services and infrastructure support, which is increasingly finding favor with investor interest from outside. Swaziland's access to markets in South Africa and the region, as well as other key markets, underlies this interest, as does the country's membership in the Lome Agreement. Such private investment, resulting in new productive facilities, contributes to employment, the balance of payments in the case of exports, the budget, and growth. A down side of this outside investor interest is the protection of authenticity for products made in the country; assurances must be provided that value added of a minimum amount (such as 25%) is contained in goods advertised as originating in the country. Failing this there may be very little benefit accruing to Swazis of so-called production in the country; instead, products may be trans-shipped through for political purposes and to gain access to regional and foreign markets for essentially South African products.

Employment opportunities for a rapidly growing labor force is perhaps the central development problem. Employment opportunities for Swazis in South Africa cannot be assured in the future, thus this safety valve for domestic surplus labor is uncertain. A continuing migration of refugees from Mozambique adds to the employment demand. Wages must be competitive and restrained if employment is to derive from additional investment in the magnitudes required. Since government does not intervene in private sector wage decisions, the establishment of public sector wages and the minimum wage are tools available to promote wage moderation. Also the location and nature of investment needs to be such as to contribute to relieving unemployment, meaning that much of it should be located in rural areas and/or focused on agriculture and agro-processing.

Credit availability is a key to stimulating development of small businesses and agriculture. Here the financial system has had difficulties in granting credit to such small borrowers and the losses have been heavy. More successful credit programs for small business and agriculture, especially within the traditional land tenure system, are needed. The country has been a beneficiary of depositors' increasing preferences to keep funds in Swaziland rather than South Africa, where deposit rates are higher. A progressive lowering of deposit rates has not stemmed this influx of deposits. At the same time, lending rates have been pegged to those in South Africa, thus making capital expensive while loans granted have been lucrative for banks. There is a need for institutional innovation and increased competition in the financial sector if available capital is to be distributed more widely and to be channelled into priority private sector uses consistent with national objectives.

Strong export growth stemming from new investments in manufacturing and mining offers prospects for improved balance of payments conditions over the medium-term. This will likely support substantial growth in imports in real terms. But all of this is linked to remaining competitive in world markets, which is tied to South Africa's policy of depreciating the rand to maintain its own competitiveness for nongold exports. An alternative, if the rand is allowed to appreciate, would be abandonment of the peg between the rand and the lilangeni. The costs of such a devaluation against the rand would come in terms of inflation and erosion of confidence, perhaps affecting capital movements and the interest rate. The tight relationship of the two economies means that a devaluation would not likely produce a major shift in the level or structure of prices of goods. Devaluation would then have to provide benefits via wage competitiveness, real incomes and absorption. Other policy instruments might be better to achieve increased competitiveness, since exchange rate policies may not be a close substitute for fiscal policy measures.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

The Swazi currency is pegged to the South African rand on a one to one basis. Freely exchangeable, the Central Bank of Swaziland quotes exchange rates for the various convertible currencies and also for the PTA and SADCC countries in Africa. There are no taxes or subsidies on purchases or sales of foreign exchange. Within the CMA, which is treated as a single exchange control territory, there are no restrictions applied to payments. Similarly for countries outside of the CMA, Swaziland applies exchange controls similar to those of South Africa. There are no bilateral payments arrangements.

Payments for imports within the customs union are made in domestic currency which is freely convertible; payments for other imports are supported by automatic availability of foreign exchange upon issuance of import licenses. Export proceeds from outside of SACU are to be surrendered to the Central Bank as part of the country's foreign reserves. Invisibles are similarly relatively free of control. Payments to nonresidents for current transactions, while under Government control, are usually not restricted. Capital being brought into the country must have prior approval of the Central Bank, which then facilitates later repatriation of interest, dividends, profits and other income.

2.B. Import Administration

As a member of the SACU there are no import restrictions on goods originating in any member country of the customs union. Imports from South Africa do not require import licenses even where such goods originate outside the customs union. For imports from non-SACU countries import licenses are required, which entitle the holder to purchase foreign exchange. As a net importer of some food products (maize, vegetables and processed food) there is room for some import substitution if efficiently produced. Encouragement would have to come through indirect encouragement in light of the common tariff structure of SACU, although there is provision for some infant industry protection.

2.C. Export Policies

Swaziland licenses all exports, primarily for revenue reasons. Goods shipped to other SACU countries are licensed for purposes of taxation whereas goods shipped outside SACU are licensed primarily to assure realization of export proceeds, to be surrendered into the country's foreign reserves.

2.D. Industrial Policies

The composition of industrial activities derives from the overall structure of the economy. Swaziland is well endowed with productive soils and water ranging over a number of micro-climates. These resources support a diversity of crops and harvest times as well as wide-spread commercial forests. There are also mineral resources, including iron ore, gold, asbestos, coal, daolin and diamonds and proven reserves of tin copper, nickel and chrome yet to be exploited. Public infrastructure is well developed so that products can easily move through all parts of the country and into South Africa and beyond.

Agricultural and forest products are the country's basic output and comprise approximately one quarter of GDP. Some of these commodities are processed and manufactured by an industrial sector which also produces inputs and some consumer goods; it comprises another quarter of GDP, half of that representing the processing of domestic agricultural and forest commodities. Mining has been variable in its size, with iron ore ceasing but diamonds adding to activity in that sector. Government forms the third largest sector at some 22 percent of GDP.

Primarily industrial policy revolves around investment stimulation and efforts to improve the work skills of the population. Capital formation has been high, especially by African standards, with much of that investment going to the private sector. But the ratio of investment to resulting output has been quite low because of the exceptionally open economy and resulting leakage into increased imports mostly from South Africa and because government investment has gone into long gestation infrastructure projects. The tight linkage of the economy to South Africa provides a generally favorable climate within which foreign investors can operate, while sanctions and their threat in South Africa encourage diversion of some investment projects and capital to Swaziland. A shortage of middle-level managers and skilled workers is one of the few constraints on additional production, especially in the manufacturing sector. Continuing national resources, supplemented by donors, are going into manpower training and education.

Swaziland has a sound economic and financial environment within which investment can generate additional production capacity. Prices are allowed to operate freely to signal scarcity and efficiency aspects of production. Minimal government involvement in the economy means that the types of manufacturing entities arising will largely be sound, financially viable and competitive with regional and world prices of competing products. Thus, growth has and will focus on resource- and agro-based private industry. As long as macroeconomic policies are kept steady and severe disruption does not flow through South Africa to affect Swaziland, the major constraint on manufacturing activity will likely be a scarcity of skilled labor. With programs and projects in place to help alleviate this bottleneck, Swaziland is well positioned to take advantage of the changing investment climate in South Africa and the appeal of Swaziland's economic stability to attract investors positioning for the Southern African regional market.

The Government has instituted an active policy to attract new producers, built around a number of incentives to the first firm in a new industry. These include a 5 year tax holiday on profits up to one and one half times the initial capital investment. More generally, the country can offer an opportunity to export to South Africa within the SACU and to other favored markets in the PTA and SADCC as well as the European Economic Community under the Lome Convention.

Any strategy of industrial development must include several measures: aggressive efforts to attract investors from industrial and Far East countries; and strengthening of key institutions such as the National Industrial and Development Corporation, Small Enterprises Development Company and the Swaziland Development and Savings Bank so that they can help new investors and small enterprises financially and technically. This will help exploit the good potential in the country for agro-processing and rural-based production. Competition with Swaziland is intense from the homelands in South Africa which offer lucrative incentives to new investors, although there are increasing reasons for investors to question placing additional production facilities inside of South Africa given favorable alternatives close-by.

3E. Price Regulation

The open, market oriented nature of the country's economy means that nearly all prices are market determined. The only exceptions are the consumer price of fuel and producer prices of cotton, milk, maize and tobacco. These producer prices are adjusted frequently to market conditions, especially to changes occurring in South Africa. This tight linkage to South Africa means that Swaziland inflation follows closely trends in South

Africa, except for differential sales taxes and transport costs. Thus, when the rand was depreciated in 1985 against major world currencies there was a sharp increase in inflation in both countries due to higher domestic costs of imports. More recent increases in South African inflation will be passed through to have similar impacts on Swaziland.

2.F. Fiscal Policies

Control over fiscal policy is limited in Swaziland to the extent that a major source of revenue is derived from receipts from the country's membership in SACU. There is a formula used for determining Swaziland's share, which among other aspects bases the current revenue transfers on activities in the customs pool two years previously. Over half of revenue comes from SACU receipts which itself is a decline from prior proportions of revenue. Sales tax revenue has increased substantially in absolute terms and as a percent of total revenue, partly due to major rate increases in 1986. An income tax on individual and businesses comprise the rest of the major sources of revenue.

Expenditures are divided between recurrent and capital projects. Government has been relatively responsible in limiting expenditures such that the fiscal deficit has been below 3 percent of GDP. In the face of declining revenue, Government has been able to restrict capital projects and make cuts in recurrent expenditures including a slowing of civil service employment. Financial improvements are needed in some government agencies and in parastatals requiring government subsidies, including the Central Transport Administration, Royal Swazi Airways, Swaziland Railways, and the National Industrial and Development Corporation of Swaziland. A Public Enterprise Monitoring Unit and measured to improve efficiency in these public entities have been of some help, but more effort is required. In addition, a close scrutiny of the efficiency of public expenditure is necessary. This should evaluate the objectives of services like education, where increased emphasis on vocational and skilled manpower training may increase productivity in the economy and reduce bottlenecks caused by shortages. Similarly evaluation of health expenditures may improve services and provide for better maintenance of facilities already constructed. Improved project identification and implementation requires better management and coordination with private sector investments. Donor coordination and effective use of external assistance programs would increase the flow of resources and raise the country's absorptive capacity.

2.G. Financial Sector Policies

The Central Bank is responsible for currency issue, management of public debt, administration of exchange controls, and regulation of financial institutions. Starting April 1, 1986 when the Rand Monetary Area was renegotiated and renamed the CMA, the rand ceased to be legal tender in Swaziland, the requirement that it be backed by rand for the Central Bank's issuance of emalangeni was removed, and the country became free to conduct its own independent exchange rate policy. However, in practice the rand continues to circulate and back the Swazi currency.

Interest rates in Swaziland are largely determined by economic conditions in South Africa, which is reinforced by the right of Swazi citizens to bank in South Africa or Lesotho. Practical considerations, apparently, encourage a large number of Swazis to hold their bank balances in Swaziland even when the deposit rates earned are below those offered in South Africa. Lending rates in Swaziland, on the other hand, have closely tracked those of South Africa, making for a large spread between deposit and lending rates. When South Africa depreciated its currency (and thus the lilangeni in practice) and inflation spiraled in 1984 and 1985, interest rates rose rapidly. Since that time, however, rates have declined following the influence of South African monetary policy. In Swaziland the prime lending rate has mostly remained positive, standing above the rate of inflation; but the interest rate spread means that the deposit rate has been sharply negative.

2.H. Other Policies

Agricultural growth is a key to provision of employment, growth of commodity exports, and expansion of manufacturing prospects in agro-processing. Development of commercial agriculture and forestry on privately-owned land has been satisfactory in the past, resulting in capital-intensive, export oriented production of sugar cane, wood pulp, cotton, pineapple and citrus. But development of the Swazi National Land (SNL) which is owned by the King and administered by local chiefs has been a disappointment. A Rural Development Area Program sought to develop SNL land, but was not successful. Despite provision of social and economic infrastructure within a program intended to use technology and extension services to raise yields, output did not increase. One cause of the problem was an assumption that the program would result in additional labor applications on the land; the reality has been a heavy diversion of rural labor to wage jobs in the modern sector with which rural agricultural compensation did not compete. As the urban-rural wage differential narrows due to rising unemployment in urban areas, higher population growth, and declining opportunities for workers to migrate to South Africa, the problem may be narrowed but not eliminated. And yet, the rural sector will have to generate most of the new employment opportunities in the future. Improvements in labor productivity, which raise income generation possibilities, can contribute to solving this problem. Likewise more attention needs to be focused on the degree to which the SNL land tenure system is a bottleneck to development and discqurages the type of investment which would raise agricultural productivity.

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Annex J:

TANZANIA:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

Tanzania's socialist approach to development was laid out in the 1966 Arusha declaration. This remained the organizing principle at least until the early to mid-1980s. During the late 1960s and 1970s large scale industry, commerce and finance were nationalized and farmers' cooperatives were replaced by government authorities responsible for collection, processing, and marketing of all major export crops. National plans stipulated investment goals and production targets, fixed commodity prices and generally supplanted market forces. Import substitution proceeded to span industrial development across a broad range of sectors including heavy industrial capacity.

In its early stages this approach to development appeared to be successful. Between 1966 and 1973 gross investment rose to approximately 20% of GDP while GDP grew at 4.4% per year. Much of this growth was in social services and administration; physical output grew much more slowly and agricultural output increased by only 2.3% per year in real terms. Industry expanded its capacity at a rapid rate but output rose little relative to the growth in investment as a major part of production came in the form of inefficient import substitution operations.

The last part of the 1970s witnessed what appeared to be continued prosperity, although increasing signs of structural weaknesses appeared. The rate of real GDP growth was 5.5% per year from 1973 to 1978, based almost completely on a rapid rise in commodity prices which led to higher values for Tanzania's exports (principally coffee and cotton). This is shown by a 38% improvement in the terms of trade from 1972 to 1977; during the same period the volume of exports remained fixed and production of goods for the home market likewise did not increase.

Government fiscal and monetary policy fueled the prosperity, but also established conditions contributing to a subsequent collapse of growth. Expenditures outstripped tax revenues, leading to fiscal deficits and a rising national debt. The money supply tripled from 1973 to 1978 and inflation rose be an even higher proportion. There was a rapid rise in imports which far outpaced growth of exports. This led to a large trade deficit

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which grew in spite of quantitative restrictions on imports introduced in 1975. The trade deficit brought about a deteriorating foreign exchange reserve position and worsening balance of payments problem. There was increased dependence on foreign borrowing and donor assistance. Thus by the end of 1978 the economy was vulnerable to external shocks.

The period after 1978 witnessed serious deterioration of the Tanzanian economy. Real GDP remained unchanged from 1979 to 1985 while population growth brought about a drop in per capita real GDP by 12%. Output of industry and export-oriented agriculture declined and the subsistence sector gained in relative importance. A serious deterioration in the terms of trade occurred due to the second oil shock in 1979 and a subsequent collapse of commodity prices. During the period 1979 through 1981 there was a severe drop in the terms of trade so that it stood 15% below its 1972 level. Other adverse shocks came from severe drought in the late 1970s and a 1978-79 military conflict with Uganda.

The 1979 recession seriously affected government revenues while fiscal expenditures rose rapidly. This exacerbated the fiscal deficit and recourse to central bank borrowing, leading to sharp price increases from excessive aggregate demand for available supplies. In response, Government devalued by 10% in 1979 but this was inadequate in the face of the structural imbalances in the economy. Resort to quantitative restrictions on imports increased and was successively made more complex in efforts to ration scarce foreign exchange and assure that priority sectors received adequate imports. Ceilings on nominal interest rates led to a similar excess demand for credit and efforts to ration available funds. With an overvalued exchange rate and a negative interest rate, those enterprises favored by the allocation system were subsidized and others penalized, all in an environment of administrative decision-making rather than market forces. In the process, these administrative efforts to direct the economy hurt export-oriented agriculture and food production fell, leading to a food crisis.

There was an aborted IMF Standby Facility negotiated in September, 1980 which Tanzania did not comply with in curtailing public expenditures, reducing the money supply and devaluing the currency. Foreign aid levels meanwhile were rising in relative importance. After rising during the 1970s, donor assistance dropped from 1980 to 1983. At the same time, official aid as a percent of GDP which was 4.4% in 1970 rose to 13.7% by 1980, thus making any decrease in aid serious for the economy.

Initial efforts to reform the economy came in 1980 and 1981 as economic "survival plans." The 1981 National Economic Survival Programme (NESP) had as its main objectives:

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1. an aggressive export drive in order to increase substantially foreign exchange earnings;
2. judicious use of available foreign exchange so as to enhance earning capacity as well as save on imports;
3. the elimination of food shortage through in-expensive small-scale village irrigation projects as well as the cultivation of drought-resistant food crops;
4. strict control of public spending in both Government and parastatals;
5. development plans should emphasize consolidation in contrast to expansion of new activities;
6. expansion of the scope and capacity for self-reliance in all sectors of the economy and raising the productivity of the workers and farmers through appropriate incentive schemes.

This was followed almost immediately by a three year Structural Adjustment Programme (SAP) for 1982/83 through 1984/85 announced in June, 1982. The intention was to restore balance in the economy and rationalize use of resources through domestic efforts and external assistance. The main objectives of the new effort at adjustment were to:

1. reduce the rate of inflation through adjusting the government budget to levels that are consistent with the growth of the national economy;
2. achieve balance of payments adjustment so as to alleviate the existing extreme foreign exchange scarcity and the consequent domestic production capacity underutilization;
3. achieve an increase in the productivity of parastatal enterprises and improvement in public sector management;
4. maintain the already achieved equity in income distribution as well as the provision of social services and basic needs to the majority of the population.

The SAP which started in 1983/84 undertook some bold moves towards reform. The currency was devalued by 40%. Producer prices were increased on average 50% and the grain purchasing monopoly of the National Milling Corporation was terminated. Crop authorities, which handled products from farm gate to export sale, were dissolved with cooperatives and export to marketing boards introduced. To attack the budget deficits subsidies were reduced and controlled prices on many agricultural inputs and consumer goods were raised. Government undertook cuts in size and froze hiring. To encourage exports and ease the foreign exchange shortage, export enterprises were allowed to retain a part of their foreign exchange earnings to use for approved import commodities. Also enterprises were allowed to import using their own funds, with the intent of indirectly repatriating funds held abroad.

By 1984/85 this reform effort was also stalled. The incentives to exporters of the one-time devaluation and increased producer prices were eliminated by continuing inflation. The Government was unwilling to proceed with other structural reforms and those introduced had been insufficient to stimulate major economic recovery and to stop the deterioration of the balance of payments.

Thus, after several years of initial efforts at economic reform the Tanzanian economy still faced serious problems. There had been a continuous decline in output and export earnings, leading to a reduction in the domestic saving rate and rapid fall in import volumes. With the fall in imports, shortages of inputs and consumer goods led to further decreases in production and a deterioration in the capital stock. There were high rates of inflation, large balance of payments deficits, increasing debt and accumulation of external payments arrears.

The latest and current effort at economic reform is the Government's Economic Recovery Program announced in the 1986/87 budget and presented to the Consultative Group meeting in June, 1986. A three year program covering the 1986/87 through 1988/89 budget years, it has as medium-term objectives to achieve a positive growth rate in per capita income and a low rate of inflation, while restoring a sustainable external balance of payments position. To achieve these objectives the following strategies were announced in June, 1986:

1. to increase the output of food and export crops through appropriate incentives for production, improving marketing structures, and increasing the resources available to agriculture;
2. to increase foreign exchange earnings from exports. The objective is to increase exports earnings by 11.6% in 1987, 19% in 1988 and 19% in 1989 from US$400 million expected in 1986;
3. to rehabilitate the important physical infrastructures of the country such as transport and communications, energy and water in support of the directly productive activities;
4. to increase capacity utilization of the existing industries and restore the sector's contribution to GDP through the allocation of foreign exchange to priority industries with capacity for increased efficiency and productivity. The target is to increase the level of capacity utilization from between 20 to 30% to a level of 60 to 70% by the end of the recovery program.

An initial set of reform measures was announced at the time of the 1986/87 Budget. These included an exchange rate

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adjustment from Tanzania shillings 17 to the U.S. dollar in mid-April 1986 to T Sh. 40 in June, 1986, with subsequent adjustments in the rate to be made gradually so that an equilibrium rate would be reached by mid-1988. Interest rates were increased, with the 12-month savings deposit rate rising 5 percentage points to a rate of 15%, the objective being to achieve a positive real interest rate by mid-1988. Nominal producer prices for agricultural exports were increased ranging from 30 to 80%. There was a start at decontrol of domestic prices (except for 12 identified categories of commodities) with one third decontrolled in July, 1986. Restrained fiscal and monetary policies were adopted while institutional and policy reforms sought to improve the efficiency of the agricultural, industrial and transport sectors. In support of these reforms the IMF approved an 18 month Stand-by arrangement on August 28, 1986 and the World Bank approved a Multisector Rehabilitation Credit on November 20, 1986. Other donors also contributed to supporting the reform efforts.

The medium-term strategies and policies of the Government under the Economic Recovery Program are spelled out in the Policy Framework Paper for 1987-90. Coming after 1 year of policy changes under the ERP, the Paper identifies the additional changes necessary, in Government's view, to achieve a sustainable rate of growth under conditions of external and internal balance. The principal structural adjustment measures the Government proposed to take during 1987-90 were:

1. the allocation of foreign exchange on a priority basis to the most efficient enterprises to ensure increases in industrial capacity utilization and widespread improvements in the efficiency of industrial production;
2. reductions in the cost and improvements in the responsiveness of the agricultural marketing system;
3. reduction in the budget deficit and improvements in the structure of revenue and expenditure, aimed in particular at increasing resources for the maintenance and rehabilitation of existing capital assets;
4. increased flexibility and improved efficiency in the financial system;
5. greater reliance on correct price signals.

To achieve these goals the Government is committed in the Policy Framework Paper to reinforce the policy and institutional reforms started during 1986/87 over the 3 year period 1987/88 to 1989/90. During this multi-year period the following accomplishments are to be achieved:

1. an average rate of economic growth of at least 4% per year, leading to a positive growth in per capita income of approximately 1% per year;

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2. a reduction in the domestic rate of inflation from about 30% in 1986/87 to below 10%in 1989/90;
3. a reduction in the current account deficit (excluding government transfers) from 176% of merchandise exports in 1986/87 to 122% in 1989/90, leading to a restoration of a sustainable balance of payments position by the early 1990s.

This general description of the economic reform package being undertaken by Tanzania is supplemented below by a description of its major components. Tanzania has undertaken a comprehensive structural reform package which, if sustained, will correct many of the distortions in the economy and lead to a more sustainable basis for continuing growth. Coming after two decades of heavy direct government involvement in all segments of the economy, it requires a virtual revolution in the organization of the economy, its management, and the incentive structure allocating resources and motivating people's economic activities. The risks are high and it is not a foregone conclusion that the Government will maintain its political will to see the reforms through to the point when the economy should respond with sustainable growth.

What must be remembered in the face of these bold reform undertakings is how far the economy must go before it can function more efficiently. Further, it must be recognized that there is serious ideological and political opposition still in place to the types of reforms being undertaken and the type of more market-oriented economy which should result. There are numerous ways for the reform process to get off-track and either be delayed or reversed completely. In a real sense the easiest if boldest decisions have been made; what remains requires a long process of re-educating and convincing many middle level bureaucrats and managers that direct administrative intervention and command control of the economy, a two decade fixture of the Tanzanian economy, must be replaced by indirect control through prices and market signals.

Another dimension of the problem relates to rehabilitation. The economy's capital stock has deteriorated severely, both in the public and private sectors. Some initial increases in production are possible with existing capital stock, but over the medium term massive investment is required to bring productive capacity to a point where it can be competitive. The same must be said of human capital, which must be made more efficient and productive.

It would appear that another five years at a minimum would be required to move the economy to an acceptable level of sustainable growth. This would require perseverance by the Government in continuing its reform efforts and continued and even increased assistance from donors.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

Essential to continued structural reform will be an active exchange rate policy linked to reform of the exchange and trade regime. The current exchange rate adjustments started in April, 1986. Achieving an equilibrium rate would be consistent over the 3 years of the Policy Framework Paper to achieve the target rate of economic growth and a current account position which can be financed without undue restrictions on current account transactions and related payments. As the exchange rate is moved toward equilibrium, the Government will start removing existing trade and exchange restrictions, relying increasingly on tariffs and other indirect economic levers to influence developments in the balance of payments.

2.B. Import Administration

As the exchange rate is adjusted towards a more realistic scarcity-based price for foreign exchange, the Government is committed to increase the proportion of imports free of exchange and trade restrictions. Starting January 1, 1988 Government planned to issue import licenses and foreign exchange "on demand" for selected commodity imports, then gradually broadening the coverage so as to include all industries and categories of goods consistent with the Economic Recovery Program by 1989/90. The Government carried out a study of the tariff system, with the assistance of the World Bank, which will be used to consider modifications in the tariff structure. Such changes in tariffs would be implemented in the 1988/89 fiscal year, attempting to maintain revenue neutrality across the changes made.

2.C. Export Policies

The Government plans to review periodically the export retention scheme and "own exchange" import scheme in light of other changes being made in the exchange rate and the import licensing system. An increasing proportion of imports are entering the country through these two scheme, thus making them major sources of supply for spare parts, intermediate goods, and consumer goods in the case of the "own exchange" scheme. The export retention scheme was revised in September, 1986 to encourage more optimal use of retained proceeds. The Policy Framework Paper reported that Government had made yet another review in August, 1987 and implemented new modifications regarding easier access to foreign exchange, a narrowing of retention rates, and a rationalization of the import and export lists and pattern of utilization. The Seed Capital Fund for new exporters supplements the retention scheme by assisting producers in obtaining initial imported inputs to start exporting. It further has its own retention provision, making the set of export incentives potentially overlapping and complex.

2.D. Industrial Policies

The industrial sector has severe problems which must be addressed. These include high import dependence, inadequate infrastructure, low capacity utilization, shortages of skilled manpower, and the existence of a large number of inefficient operations. On a selective basis sectors will have to be rehabilitated through access to raw materials, spare parts, and infrastructure. Productive enterprises will have to be selected and nurtured. Changes in the exchange rate, trade regime, and pricing measures will assist in this selection process. Also the Government and the World Bank were to undertake studies during 1987 to identify and map out an action program of restructuring and rationalizing the industrial sector. It was intended that such studies would be completed during 1988. When implemented, such a strategy should free up resources for use by the more efficient firms so that their output could expand rapidly and at low cost through better use of existing idle capacity. Combined with a public investment program which is to improve infrastructure serving production, there should be a rapid improvement in output and efficiency of the sectors selected for rehabilitation.

2.E. Price Regulation

Under the reform programs prior to and including the Economic Recovery Program, there has been a significant reduction in the number of products subject to price controls. This trend of decontrol is to continue. Except for a maximum of 12 categories of commodities considered essential consumer items, which comprise about 15% of the consumer price index, the Government has made a commitment to decontrol remaining commodities before the end of the fiscal year 1988/89. Some two-thirds of these products were decontrolled at the beginning of 1986/87 and 1987/88, with the remainder scheduled to be decontrolled at the beginning of the 1988/89 fiscal year. Efforts will be made during the period of decontrol to make rapid adjustments in controlled prices to avoid cost-price imbalances and growing subsidies. A related commitment is to reduce domestic distribution controls of commodities as their prices are decontrolled.

2.F. Fiscal Policies

During the 3 years of the Economic Recovery Program the Government is committed to annual overall deficits (with foreign grants treated as financing) of no more than 13% of GDP. This will assure large reductions in the need for domestic bank financing of Government debt, freeing up credit for productive sectors and reducing the rate of monetary expansion. Reliance on external borrowing will be constrained so that the external debt service ratio can be kept manageable. This will require improved tax administration and tight expenditure control.

The Government undertook significant measures during 1986/87 to increase revenue and improve the efficiency of the tax system. This included a conversion of most remaining specific sales taxes to an ad valorem basis, a reduction in the high marginal tax rates on personal income, and increases in local sales tax rates. These, combined with efforts to improve tax collection and administration, set a base for improved tax revenues. Such efforts will continue during the remainder of the Economic Recovery Program period.

In the 1986/87 budget there was a freeze on employment in the civil service except for teachers and medical personnel. Also the Government maintained its policy of no budget subsidies for parastatals. Paramount in expenditure control will be control of the wage bill to assure that it grows slower than the rate of inflation. In addition to the freeze on civil service hiring, there will be a need to rationalize the bureaucracy and retrench in appropriate places. A Presidential Salaries Commission has reviewed public sector salaries and will seek to maintain incentives among staffs of Central Government, local governments, and parastatals. The 1987/88 budget specified a real reduction in the wage bill and cuts in most other areas of discretionary recurrent expenditure. Improved management and control of the budgeting process and movement to a medium-term strategy for public expenditure will also be undertaken to help control expenditures and assure prioritization of public service provision.

Public infrastructure, especially roads, are in severe disrepair. Their rehabilitation will require a move away from new public capital investments to maintenance and rehabilitation of the existing capital stock. Without improvement of public infrastructure, production faces excessive costs related to use of public services and facilities, thus constraining increased efficiency in production. Therefore development expenditure will be confined to ongoing projects and rehabilitation, with new projects started only if absolutely essential for economic recovery.

Public enterprises play a large role in the Tanzanian economy. The Government's main objectives for these public producers will be to accelerate the restructuring process started in 1984/85 and to improve management and operations so that there will be adequate return on investment. Some agricultural parastatals have already been reorganized and rationalized. A detailed review of the parastatal sector will propose which public enterprises should be rehabilitated and an action plan will be prepared with a schedule for implementing policy and institutional changes.

2.G. Financial Sector Policies

The objectives in formulating a monetary and credit policy are to strengthen the balance of payments and reduce the inflation rate. As the fiscal deficit is reduced as a proportion of GDP, credit will increasingly become available for the productive sectors of the economy. Control will be tightened by use of quarterly domestic credit and government credit expansion targets. The interest rate was scheduled to be made positive in real terms by the middle of 1988, thereby reducing the need for credit allocation. By July, 1987 the one-year deposit rate had reached 80% of the inflation rate and continued progress towards positive real rates is inherent in the Economic Recovery Program.

2.H. Other Policies

Agricultural reform is key to improving the economic growth rate in Tanzania. Parastatal reforms will have a large impact on production and marketing. Progress is also needed to enhance the institutional structure for processing and marketing Tanzania's export crops as improvements in agricultural production move forward. Without such companion improvements, export earnings will not keep pace with balance of payments projections. Some progress has begun relative to export crops. The responsibilities of what were formerly crop authorities have been assigned to newly constituted or created cooperatives and marketing boards. Private tea and sisal estates are now allowed to market directly instead of through marketing boards. Starting in 1987/88 cooperative unions and other large producers will be allowed to export directly rather than through agents. Further improvements in the roles of cooperatives and other private institutions related to agriculture will be made as the prominence of marketing boards is limited further. Action programs to stimulate production, marketing and export of cotton, coffee, tobacco and other crops will be completed by mid-1988, with implementation scheduled to start during the Economic Recovery Program period.

In addition to more efficient marketing institutions, the provision of adequate price incentives is necessary to increase agricultural production and exports. Over the life of the Economic Recovery Program the Government has made a commitment to increase official producer prices for export crops to a level equivalent to 60-70% of export prices (f.o.b.) or to ensure a real increase of at least 5% annually over the medium term, which ever is higher. Also Government will allow greater price differentials to reflect quality, thus encouraging production of higher grades of crops. Reduced administrative allocation of agricultural inputs was boosted by decontrol of the importation and distribution of all agricultural inputs other than fertilizers and seeds effective March, 1987.

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Export Enterprise Support (EES) Project

Annex J:

ZAMBIA:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

In Zambia May 1, 1987 is a dividing point in policy dialogue and formation as well as economic management. From early in 1983 until May 1, 1987 Zambia closely cooperated with donors in what was called an Economic Recovery Program. This included traditional liberalization measures and an exchange auction system for valuing and allocating foreign exchange. On May 1, 1987 Zambia broke away from continued liberalization under the Economic Recovery Program, citing a failure of those policies to deal with the country's problems. In its place Government announced a New Economic Recovery Program, with an Interim National Development Plan for the period July, 1987 through December, 1988.

From 1964 at independence until 1973 Zambia experienced moderate rates of economic growth and relatively stable financial conditions, both stemming from favorable export prices for copper which accounted for over 90% of export earnings and some 50% of GDP. During the same period the country developed a large and diversified industrial base, ranging from chemicals to light manufactures, but almost all within the public sector. Such state ownership of industrial enterprises and a generally active involvement of government in the economy brought with it economic policies which included heavy protection of domestic industry and large subsidies for urban consumers. These policies led to disappointing growth of agricultural output, resulting in a change from food grain self-sufficiency to import dependency. An overvalued exchange rate penalized non-traditional exports and, along with negative real interest rates, stimulated capital and import intensive production and consumption. Heavy public sector investment, especially in the transportation sector, had a small direct impact on growth.

1973 brought severe problems including an economic contraction and external payments difficulties along side increasing fiscal problems. From 1973 to 1984 real GDP declined approximately 1.5% per annum; a population growth rate of 3.1% meant per capita GDP in 1984 was 35% lower than in 1973.

Depressed copper prices and a failure to adjust domestic expenditure and production to the deteriorating external situation are the prime reasons for this severe economic downturn. Government resorted to external borrowing to maintain levels of economic activity, in the process incurring massive debt which severely limits development options now and into the future.

Deterioration in the external terms of trade was an integral part of this economic downturn. Copper prices fell by 70% from 1973 to 1985 while prices of imported goods, especially petroleum, rose rapidly, resulting in a 75% worsening of the terms of trade for Zambia. In reaction restrictive exchange and trade systems were put in place to cushion the economy from these external shocks. Shortages of foreign exchange led to low capacity utilization levels and deteriorating capital stock. This, in turn, lowered production further; in mining physical output fell which worsened an already serious foreign exchange crisis. Government maintained expenditures while the tax base and collections fell, leading to large deficits. Tight controls on prices, interest rates, and the exchange rate brought in increasing distortions while tariff and domestic tax policy encouraged capital and import intensive domestic industry.

Early in 1983 Zambia undertook a fundamental restructuring program, with assistance from donors. Among the elements of the reform package were a start at domestic price decontrol, reduced budgetary subsidies for basic foodstuffs and fertilizer, movement of agricultural producer prices towards parity, loosened interest rate ceilings, and adoption of a more flexible exchange rate policy. Because of the severity of the imbalances, the tentative nature of the reforms undertaken relative to the total changes needed, a downturn in donor assistance, and a further compression of imports for lack of foreign exchange, the economic situation worsened during 1983 and 1984. Tentative improvements in the economy, partly flowing from the policy changes initiated in the previous two years, brought the first increase in real GDP of 3.4% in 1985 with substantial help from a good agricultural harvest and increased manufacturing output. But the fiscal and external imbalances grew worse.

Late 1985 brought radical changes in economic policy as Zambia redoubled its efforts to stem the crisis. These changes included resort to a weekly exchange auction starting in October, 1985 to allow market determination of the kwacha exchange rate. This was accompanied by major liberalization of the trade and payments system. Interest rates were decontrolled through daily auctions of treasury bills. Fiscal and monetary policies were brought into line with these liberalizations. Price controls were drastically loosened and the severe depreciation of the kwacha was thereby quickly passed through to domestic cost-price relationships. Only maize and fertilizer remained as administered prices and government intended to gradually eliminate subsidies on these items also. In agriculture the marketing of maize was liberalized in September, 1986 and the state marketing agency became a buyer of last resort and manager of Zambia's strategic reserves.

This massive economic restructuring was supported by multilateral and bilateral donors. The IMF in February, 1986 approved a 2-year stand-by arrangement and a purchase under the Compensatory Financing Facility. The World Bank approved an agricultural sector credit in January, 1985; an industrial sector reorientation credit in October, 1985; and a Recovery Credit. Bilateral support, coordinated through a number of meetings of the Consultative Group, added external resources to the reform process. Further support was expected from debt restructuring. For 1987 the debt service ratio, in late 1986 when the Policy Framework Paper was written, was expected to be 100% of export earnings, falling to 85% in 1988 and 1989; these amounts excluded arrears on commercial payments. A major complication was that a substantial portion of Zambia's debt was non-reschedulable. Short of maximum debt relief, Zambia could thus not even look forward to minimum growth rates during the period of the Policy Framework Paper.

At the end of 1986, as reflected in the Policy Framework Paper for 1987-1989, the Government and donors considered the economy headed in the right direction The expectation was that with proper price signals and discipline in the economy, agriculture and industry would gradually become the focus of future economic growth, employment, and income.

The 1987-89 medium term reform strategy for the economy, as of end-1986, was to be:

- -greater domestic resource mobilization through improved taxation;
- -public enterprise reform;
- -privatization of some economic activity and better management of what remained in the public sector;
- -reformed exchange rate and budgeting operations by the Bank of Zambia;
- -promotion of non-traditional exports;
- -debt restructuring, essential to increase resources for the medium-term and longer.

In all of this the Government was pursuing broad objectives of economic reform:

1. to permit a resumption of economic growth adequate to at least stabilize per capita income against the annual growth of 3.1% in population.
2. to redirect domestic production and consumption so as to

move toward a sustainable balance of payments through the production of efficient export and import-substitution goods.

3. to meet Zambia's immediate external obligations and to improve relations with its external creditors.
4. to achieve internal financial stability, including the stabilization of domestic prices.

President Kaunda on May 1, 1987 announced the "New Economic Recovery Programme" in a speech, which provided this rationale for the major changes being implemented:

> "Since 1983 the Party and its Government have undertaken a succession of adjustment programmes worked out in close collaboration with the IMF and the World Bank to restructure the economy.
>
> "These programmes called for the adoption of specific macro-economic policy measures notably the following:
>
> (a) imposition of credit ceilings in order to reduce money supply;
> (b) reduction in public expenditure, especially on welfare services and subsidies;
> (c) reduction of the overall Government budget deficit;
> (d) the imposition of ceilings on wage raises;
> (e) the decontrol of prices and interest rates;
> (f) the rescheduling of the repayments of external debt;
> (g) the progressive devaluation of the Kwacha; and
> (h) the auctioning of foreign exchange.
>
> "I must point out that even as the Party and its Government were negotiating with the IMF and the World Bank on these policy measures there was wide and deep skepticism regarding the possibility of implementing such measures without bringing about wide disruptions in the economy. This skepticism was fuelled by the growing external debt which compelled the country to commit a significant and growing proportion of its dwindling export earnings to servicing this external debt.
>
> "The IMF conditionality has meant that the restructuring programme, which was and still is imperative in order to lead the economy to recovery, could only be sustained through recourse to massive external borrowing. . . .
>
> "Nevertheless, the Party and its Government decided to go ahead with the measures I have already outlined in the hope that the country's economic performance would improve and the drastic fall in the people's standard of living would be arrested.

"After four years of these experimental programmes per capita income has fallen from the equivalent of US$630 in 1981 to less than US$200 in 1987. We have observed, with growing alarm, a situation where escalating unemployment is becoming a permanent feature of our economy. Galloping inflation has set in which has pushed the prices of basic essential commodities beyond the reach of our people especially in the low income groups who are in the majority. Cases of malnutrition are on the increase everyday.

"There has been a sharp rise in the mortality rate . . . We are witnessing a situation where our social fabric is slowly disintegrating, . . . It is patently clear that far from improving our condition, we are not succeeding. Hence, the need for a fresh look.

"Comrades, what I am saying is that we shall determine our own destiny. To do this we must rely on our own resources both human and material. We must determine for ourselves the direction of our national development and pursue it with conviction, discipline, and total commitment. While appreciating the assistance rendered to us by the international community, we must nevertheless discard the 'dependency syndrome' which has over the years led us to believe that external financial institutions and donor agencies can solve our problems for us."

The New Economic Recovery Programme, as articulated in the Interim National Development Plan for July, 1987 - December, 1988, had as its principal objective stabilization of the economy by controlling inflation. To do this, steps were undertaken to control the exchange rate and interest rates, with the objective of "growth from our own resources."

The detailed objectives of this new approach, as stated in the Interim Plan, were:

1. to release resources for development by compressing non-essential and luxury imports and limiting debt service payments;
2. to reactivate the economy by increasing capacity utilization in enterprises producing essential or basic goods or goods for export;
3. to stabilize the economy by controlling inflation;
4. to promote a self-sustaining economy through increased profitability and reinvestment of profits in enterprises utilizing local raw materials;
5. to diversify exports by promoting non-traditional exports and export of manufactured goods;
6. to structure production and consumption patterns so as to use foreign exchange as a strategic resource;

7. to increase employment opportunities through the establishment of village and small scale industries based on local raw materials;
8. to increase government capacity to manage the economy; and
9. to reduce subsidies gradually and target them to the needy.

The conclusion which must be drawn from Zambia's experience with reforms and its more recent adoption of a "New Economic Recovery Programme" is that Zambian economic policies are in great disarray. Since May, 1987 a set of policies has been adopted which, while well intentioned, is incapable of stabilizing the economy, let alone of positioning it for eventual growth out-pacing population increases. The abrupt return to direct intervention and control of the economy reverses any gains beginning to appear in allowing more rational, price-sensitive production and investment decisions to function. The goals of the new program are inconsistent. Severe shortages of imports, price controls, and direct allocation intervention by the Government do not add up to an environment within which non-traditional exports will grow. Nor will there be the type of medium-term, sustainable growth in agriculture and manufacturing desired. Negative interest rates and prohibitive protection, tariff-based and quantitative, will direct any new productive activity towards import substitution. There will be little chance of attracting external investment. Favorable external conditions, weather for agriculture and world prices of minerals for mining, may well support some modest growth, but could just as easily turn adverse and reduce growth even more than these policies are likely to bring forth.

Over the longer term there will have to be another drastic change in objectives and policies. When that comes, the economy will likely require large-scale rehabilitation of productive enterprise along side of new financial stimuli more conducive to efficient production and allocation. What is presented below relates to the policy dimensions of the current approach to economic reform and their current status as best can be determined. The rehabilitation issue, possibly an essential prerequisite to improved economic performance in the future, will also have to be analyzed at the appropriate time, likely by multilateral donor missions on rehabilitation.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

With the exchange rate fixed at 8 Kwacha per US dollar since

May, 1987, and in light of the severe administrative constraints on use of foreign exchange, it is unclear as to the extent of overvaluation. The Exchange Auction prices in weeks prior to abandonment of the auction varied widely, rising above 20 Kwacha per U.S. dollar. This is not necessarily any indication of the true, market-clearing exchange rate, but it does point to the overvaluation of the present rate. Currently it is government policy to leave the exchange rate unchanged until "reasonable stability is attained," although the Minister of Finance does allow for a close monitoring and possible adjustment.

2.B. Import Administration

Foreign exchange allocation cannot be separated from import administration under current conditions. A Foreign Exchange Management Committee allocates foreign exchange to various sectors of the economy twice-monthly, while a sub-committee meets daily to make allocations under the 50% export retention scheme. But superceding this are the preferential commitments for mining, petroleum, the airline, and fertilizer, as well as the 10% debt servicing allocation. Thus, only the residual is available for allocation by the Foreign EXchange Management Committee.

What is clear from the little data available is that the availability of foreign exchange is severely tight and that chances of any economical levels of capacity utilization, outside of the 4 preferential commitments, is very small. In such an environment, even with the 50% retention Scheme for non-traditional exporters, the ability to import regularly the raw materials required is in severe trouble.

2.C. Export Policies

The Government has made an increase in non-traditional exports an important part of the New Economic Recovery Programme. The Minister of Finance in January, 1988 estimated that these exports earned US$ 80 million during 1987. He also stressed that the 50% retention scheme was an important inducement to exporting, along with a duty drawback system for taxes on imports used in production.

Of far more importance in the near-term are policies affecting minerals, primarily copper. Mines have their import requirements taken care of separate from the allocation process, off the top from gross foreign exchange earnings. Favorable copper prices can do a great deal to ease foreign exchange constraints. However, deterioration of mining equipment and gradually dwindling stocks of minerals means that over the longer term there must be alternative export earnings.

It is not possible to assess the situation for non-traditional exporters on the basis of what little is known of the economic situation after May, 1987. On the one hand, the 50% retention scheme, to the extent exporters are allowed to use it and import their requirements, could be a vital safety-valve encouraging production for export markets. On the other hand, the overvalued exchange rate means that financial incentives point towards production for the protected domestic market to the extent that price controls allow for prices above costs.

2.D. Industrial Policies

There is a very high dependence of manufacturing on imported inputs, which has resulted in low capacity utilization, except for some producers during the exchange auction period. Under the Interim Plan industrial strategy is supposed to encourage processing of local raw materials and give priority to full utilization of existing industrial capacities. It is also planned that industry would support agricultural development through provision of essential inputs such as machinery and equipment, stockfeed,fertilizers and chemicals, giving special consideration to the input requirements of small-scale farmers. There are to be three categories of manufacturing industries targeted for reactivation during the Interim Plan period: manufacturers that produce essential commodities; manufacturers that produce intermediate goods, and manufacturing industries that produce goods for export.

Such an industrial strategy is so vague and inconsistent as to not be a strategy, but rather wishful thinking. The imported inputs, let alone capital goods, are not available under the tight foreign exchange situation. Massive restructuring is implied in a redirection of currently import-intensive producers to processing of local product. At the same time, the three categories targeted for reactivation will require substantial imports for rehabilitation.

2.E. Price Regulation

Under the New Economic Recovery Programme price control was reintroduced to "stabilize" the economy, just as it was nearing elimination under the previous Economic Recovery Program. The extent of such price control is unclear. The Minister of Finance's January, 1988 Budget Address talks of controlling prices of essential commodities, initially limited to 12. But the October, 1987 Progress Report on the New Economic Recovery

Program talks of having brought 21 items under price control.

What is clear is the prevalent role which price control has been assigned in holding down inflation. Operating from the assumption that fixed exchange rates and interest rates eliminate the prior causes of inflation, the Government is operating to hold the lid on prices through price controls. This reintroduces the rigidities and distortions of administered prices.

2.F. Fiscal Policies

In the President's Speech announcing the New Economic Recovery Programme it was stated that Government would widen the revenue base, which would result in a more equitable tax structure such that it would be profitable to use property and unprofitable to pursue speculation and hoarding. It was also stated that the import tariff system would be revised to discourage capital and import intensive means of production. Related to expenditure changes, the President announced new expenditures would be necessary for public works schemes to reduce unemployment and on public projects with low-cost and short maturities.

2.G. Financial Sector Policies

There is recognition under the New Economic Recovery Programme that control of the money supply is essential to holding down inflation. However, the Minister of Finance reported in January, 1988 that the money supply had grown 60% during 1987, down from 93% during 1986. But reduction of the Government's deficit is an essential companion to slower growth of the money supply. During 1987 the deficit was estimated by the Minister of Finance as K1.6 billion, down from K2.2 billion during 1986; with the bulk of the deficit financed from banking system borrowings. The pressures on government expenditures and drag on tax collection from a stagnant economy do not favor the type of fiscal control essential to holding down growth of the money supply.

Substantial crowding-out of private sector and productive investment occurs under a situation of attempts to tighten the money supply and constrain fiscal deficits. The Government talks about assigning "priority" in borrowing to productive purposes in agriculture, manufacturing, mining, transport, tourism and non-traditional exports; at the same time it talks of restricting credit to other private and parastatal bodies and individuals.

2.H. Other Policies

Mining is by far the most important sector in the economy now and for the medium-term. Government has focused on providing that sector with necessary foreign exchange. It is also attempting to foster rehabilitation, with a resulting growth of copper output of 5% in 1987 over 1986 and more results expected in future years. The favorable upturn in copper prices along with cost-cutting measures by Zambia Consolidated Copper Mines, as part of a five year production and investment plan, could generate additional foreign exchange earnings if the trends continue. But over the longer term it is clear that the copper reserves are exhaustible and world prices subject to long periods of decline. Therefore there is at best a limited number of years during which copper can "pull" the economy towards restructuring and alternative sources of export earnings.

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Export Enterprise Support (EES) Project

Annex J:

ZIMBABWE:

ECONOMIC POLICY PROFILE

1. LIBERALIZATION STRATEGY OVERVIEW

At Independence in 1980 Zimbabwe faced the complex task of recovering from the war, reversing the structure of an economy designed to exploit the majority, and providing for resettlement and rehabilitation. Thus, a program of "Growth with Equity" was established to guide development efforts. The Transitional National Development Plan for 1982/83 - 1984/85 sought to start a process of fundamental transformation of the economy by reducing socio-economic dualism, evolving new patterns of production and consumption based on the needs of the people, spreading the benefits of economic growth by expanding employment opportunities, extending social services, and opening up participation in enterprise management.

During 1980 and 1981, the first two years after Independence, Zimbabwe experienced unprecedented rates of economic growth. GDP, which in 1979 was 12% below the 1974 level, grew in 1980 and again in 1981 by 16%. This reflected an improvement in 1980 in the terms of trade by 24%, as well as rapid growth in investment, and consumption. A Government relaxation of foreign exchange allocation brought in higher levels of capital and intermediate goods, which allowed the manufacturing and service sectors to grow by some 15%. Good weather in 1981 stimulated higher agricultural output, while the terms of trade improved by another 11%. Consumption and investment demand expanded in a liberalized environment of higher foreign exchange allocations. But imports rose without a corresponding increase in exports, resulting in a current account deficit in the balance of payments of some 12% of GDP in 1981. Inflation rose 13% in 1981, partly due to high Government deficits, causing a 10% real appreciation of the Zimbabwe dollar. The fast-growing domestic demand for product and slowly eroding competitive position of Zimbabwe with the outside world resulted in an actual decline of manufactured exports of 29% by the end of 1981.

In 1982 conditions worsened. The terms of trade deteriorated by 3%, with export earnings declining some 5% (measured in US dollars). The balance of payments current account deficit once again was equivalent to 15% of GDP. The

Central Government deficit stood at 10% of GDP. In the face of these disturbing trends, a stabilization effort was essential. Tax increases, cuts in Government expenditure, a tightening of control over domestic credit, and a general wage freeze were used to reduce domestic demand. The resulting contraction reduced GDP by 0.6%. One of the worst droughts on record resulted in a fall of agricultural value added by 6% in 1983.

Faced with the deterioration of the economic situation, additional stabilization efforts were adopted. The Zimbabwean dollar was devalued 20% in December, 1982, followed by a succession of additional small adjustments so that during 1983 the real value of the dollar decreased some 11% in real terms. To stimulate exports the export credit period for industrial products was extended from 3 to 6 months. Also an export revolving fund was established to provide producers with imported components of exports, thus helping to remove the foreign exchange constraint from production of manufactured exports. The balance of payments current account deficit was reduced by sharply cutting foreign allocations (some 30% in real terms). These moves resulted in some improvement, with manufactured exports increasing 11% in 1983 and 26% in 1984.

1985 brought a major agriculture-led recovery, but 1986 saw overall economic stagnation and continued decline in fixed capital investment. Foreign exchange allocations in 1987 were sharply cut back, thereby stagnating manufacturing production with its consequent impacts on higher unemployment and reduced investment. Continued drought conditions caused declines in agricultural output and income. The budget deficit for 1986/87 was some 11% of GDP, and expected to be 9% for 1987/88. Commercial bank loans of UK pounds 90 million provided some relief for foreign exchange demand, but did not resolve the underlying shortages or causal conditions.

In general since Independence Zimbabwe has experienced an unstable pattern of economic activity. Starting with a major boom in 1980-81, there followed a recession during 1982-84, a sharp but short lived recovery in 1985, with subsequent recession into 1988. Fixed investment did not recover in 1985, but rather has fallen steadily since the 1980-81 boom. Agricultural output has been highly variable and contributed to the 1985 boom. But much of the underlying variation in economic conditions has stemmed from the types of macroeconomic adjustments undertaken.

Firm control over external imbalances in the current account (from 11% of GDP in 1982 to 2% in 1986) was combined with large deficits in the consolidated public sector (including parastatals) of over 13% of GDP. This was managed with a moderate inflation rate of 10-15% and an absence of instability in domestic monetary developments. While immediate post-independence pressures required large government expenditures (to redress severe inherited inequities in public services and human capital, and more recently due to defense requirements in Mozambique), taxes effectively raised sufficient revenue to increase from 22% of GDP in 1980 to 31% in 1986/87. However, high levels of taxation and a large deficit substantially inhibit fiscal policy as a means of stabilization.

Macroeconomic management has been strong outside of the public sector deficit area. This has included management of foreign exchange allocations, monetary management and wage and pricing policy. Much of the impetus for this sound management came from a desire to avoid unmanageable external debt burdens. The country shifted from being a major net user of foreign capital from 1980-83 to being a net exporter of capital by 1986. The 1980-83 borrowing stemmed from overly optimistic expectations for exports, terms of trade gains and official capital, leaving a current external debt service ratio of some 35% of exports in 1987. However, Zimbabwe is not highly indebted and the burden is scheduled to fall in the next few years.

Key to the macroeconomic strategy of high public sector deficits and firm control over the balance of payments is an effective exchange allocation system. Controls over the capital account retain private savings balances in Zimbabwe while manipulation of the foreign exchange allocations maintain the current account and add to private sector saving while holding private sector investment down. Thus, private sector savings exceeded private investment by some 3% in 1981/82 but by 10% of GDP in 1985/86. The efficient financial system has funnelled this surplus saving into Government debt. With the economy closed to external transactions due to capital controls, the high level of savings has moderated the interest rate while allowing it to be market-determined (which has often mean negative real interest rates).

This approach to stabilization inhibits future growth, with much of the burden falling on investment by the private productive sectors in fixed capital. The pattern of instability in real economic activity alone would depress business expectations, but of more importance has been the severe rationing of foreign exchange. Maintenance of the real level of capital stock can barely be maintained, in a situation where high levels of renewal and new investment are required if there is to be future growth.

Growth in the past has depended upon a steady surplus from the primary sectors and rapid expansion of import substitution opportunities in manufacturing. Future growth must come from a more outward looking response to export opportunities. Future growth will likewise require high levels of investment to expand efficient sectors and create new job opportunities.

In this situation Government is searching for a new mix of strategies and tools to regain past levels of economic growth and stimulate job creation. There has been an impasse of sorts with multilateral donors since mid-1986, when the World Bank held up on providing a second loan for balance of payments support linked to the export revolving fund. Differences between the Bank and Zimbabwe apparently revolved around liberalization of the exchange allocation system and its necessary links to maintenance of a realistic exchange rate.

On the Government side the Ministry of Finance, Economic Planning and Development is thinking its way through the preparation of a comprehensive program of adjustments aimed at achieving a satisfactory growth in per capita income. Central to this strategy will be a study of the options for trade liberalization in Zimbabwe. Also under study are ways to reduce the budget deficit and the implications of external financing on the program. It is expected that much of this analysis will be completed by the end of 1988, with the implication that Government would be ready to formulate and implement a new package of reforms soon thereafter.

2. KEY POLICY ELEMENTS

2.A. Exchange Rate Management

Zimbabwe has had a good record of exchange rate management among countries in Sub-Saharan Africa. It has not been pegged to one currency, but rather administered as a flexible exchange rate with frequent adjustments. However, it is combined with virtually complete control over the allocation of foreign exchange, indicating that there is excess demand and a degree of overvaluation. The need to limit overall demand for foreign exchange and direct its uses to priority activities is symptomatic of overvaluation. One indication of excess demand is the annual request for foreign exchange which exceeds available supply. Another indication stems from past attempts at liberalization of allotments, when the supply was exhausted and international reserves were diminished. The continual complaint of producers is that foreign exchange is not available in adequate quantities, with resulting drops in capacity utilization. This indicates that the exchange rate would need to be adjusted substantially before it could act as a price to ration available supply among demanders willing to pay the domestic currency equivalency.

2.B. Import Administration

Equilibrium in the external accounts is achieved by rationing foreign exchange. For imports this is achieved by an elaborate and rather efficient administrative rationing procedure which uses a 6 month projection of the balance of payments within a rolling 4 year time horizon to establish available foreign exchange. After deducting legally committed uses (debt service and profit remittances) and providing for sufficient foreign exchange reserves, the remainder is available for allocation first to priority uses (such as fuel, medicines, tires, etc.) and then to sectors and entities in agriculture, mining, manufacturing,and commerce.

The experience of some 20 years in operating this tight system (dating back to the UDI in Rhodesia) has produced both bureaucrats capable of making decisions within the guidelines and rules, and an importing sector largely skilled at taking maximum advantage of the system. Based heavily upon historical shares, it provides a built-in advantage to those importers with prior access, without direct consideration of the relative efficiency of use by established vs. new demanders of imports. But complacency by established importers and of Government with the system cannot mask inherent problems. Not only is efficiency of foreign exchange use not directly measured by the allocative system, but it distorts investment decisions towards import intensive production where access is allowed. It deprives other sectors of vital foreign exchange, reducing capacity utilization and employment. Economic growth is clearly constrained by the shortage of foreign exchange in general and of imports in particular.

Another consequence of the allocation system coupled with tariffs is high to absolute levels of protection for existing producers. Given the efficiency of the allocation system and lack of a significant black market, the quotas established for imported goods through the licensing system provide high levels of effective protection. This is guaranteed by actions to prevent importation of goods which compete with domestic import substitutes and to deny new investments which would compete through domestic production with established producers. This has led to high degrees of industrial concentration and necessitates price controls to reduce monopoly profits.

There is a wide-spread and vocal "vested interest" which basically does not wish to see this administrative system dismantled and replaced by a more realistic exchange rate. Certainly there is much grumbling and many requests for improvements, meaning a larger share of the overly cheap foreign exchange, but there is a dearth of vocal opposition to continuing, with some modifications, the administrative system of allocating imports. Given the necessity of creating this system as part of UDI in Rhodesia, and the relatively short time since

Independence, this is understandable. However, it means that Government itself must be its own challenging critic to assure that the import allocation system is truly in the best interests of the country at large and not just of established vested interests.

2.C. Export Policies

There are several export incentives in Zimbabwe. One is an import duty drawback for industrial firms which export, including both the basic duty and the import surtax of 20%. This should place production and pricing on a base as if there were no import duty. In practice time delays in receiving rebates and the cost of borrowing during that delay makes it somewhat more expensive than if there were no duties levied. An export subsidy of 9% applicable to all manufactured goods acts to raise the effective exchange rate received by exporters.

By far the most visible export incentive has been the Export Revolving Fund. In fact, rather than being an incentive, it is more correctly just the avenue by which producers receive necessary imports. If one starts from the assumption that producers have a right to inputs for production, then providing these necessary inputs (in this case from abroad) is not an incentive. But if one starts from the situation of scarce foreign exchange and an overvalued exchange rate, then not everyone desiring foreign exchange will receive it. In this case the fact that exporters have been given priority of access based upon their export performance can be construed as an incentive. This is demonstrated well by the fact that during the first few years of the Export Revolving Fund producers oriented too much towards export production, creating domestic shortages. Likewise the necessity now to create a supplemental allocation of imports to exporters so that they can obtain imports for domestic production indicates the distortions introduced by this means of allocating foreign exchange.

The decision to create additional revolving funds for mining and agriculture recognizes that basic import requirements are not being met from the allocation process. Special criteria (in this case export performance) must be made explicit in the face of a breakdown in the general allocation system's ability to cater for the complex and diverse import requirements of the economy. It is predictable that there will be more splintering and specialization of the import allocation system to cater to groups found inadequately supplied through the regular allocation quotas. The alternative, and that being considered by Government, is to place more weight on the exchange rate to allocate available supplies and reduce administrative intervention. A real test of the reform process will be the willingness to move away from administrative intervention and depend on indirect macroeconomic controls. This is necessary in an evolving economy that becomes ever more complex, but it is going against the grain of vested interests and proclivity of Governments to feel most comfortable directly controlling the economy.

2.D. Industrial Policies

The manufacturing sector is highly developed and well diversified, especially by African standards. It produces nearly all types of consumer goods as well as many producer goods. Chemicals, primary metals, metal products and machinery and equipment together account for more than 40% of total manufacturing output. The sector employs some 180,000 people, over 15% of formal sector employment and it contributes nearly a quarter of GDP.

The future performance of the manufacturing sector will be critical to overall economic development. For successful adjustment of the economy, manufacturing should be a leading sector in growth of output and employment, and as a source of net foreign exchange earnings. This will require a significant expansion in non-traditional manufacturing exports, and especially over the longer term, continued selective and efficient import replacement in the intermediate and capital goods industries. The reasonably efficient character of much of the sector provides an important base for future growth, but there are also some major areas of uncertainty. The shift toward higher exports, and probable changes in production for the domestic market, will likely require significant industrial restructuring. Also much of the capital stock is old and in need of replacement. The key issue will be formulating a policy environment conducive to appropriate new investment activity.

In the Five Year Plan manufacturing is given a key role in changing the structure of the economy and for achieving rapid and sustained overall economic growth and development. The industrialization strategy is based on the long-term objective of using locally produced raw materials in production. Government will play an important role in guiding and encouraging this industrial development and redirection through increased participation in the manufacturing sector. This is a priority strategy because it is a key sector in overall economic development and the decisive sector in the physical restructuring of the economy. Also Government intends to control industries which are deemed strategic to socio-economic development, with priority given to the establishment of new industries in the intermediate and capital goods sectors because they are crucial in the establishment of an integrated industrial base.

2.E. Price Regulation

Inherently a part of the macroeconomic package of controls on the economy, price regulation stems directly from the foreign exchange allocation system and the lack of adequate competition in domestic markets. But while well-meaning, price controls create other problems. They are not equally effective in controlling all prices. They are based largely on a cost-plus basis, driving a wedge increasingly between domestic and international prices and denying the economy relevant measures of efficiency according to world standards. These combine to make domestic prices high and therefore the domestic market relatively more lucrative than the export market. A combination of exchange controls, investment policies oriented towards import substitution, and price controls create a strong financial impetus towards domestic as opposed to export activity. This can be said even with the apparent strong response of manufacturers to the export revolving fund; largely they have been using existing capacity to produce for export which gave them access to imports. Pricing of such product may well be on a marginal cost basis with the lucrative domestic market absorbing part of the cost of production. This creates a situation where domestic consumers and government (in the case of parastatals with deficits) can end-up subsidizing foreign consumption.

The price control system is elaborate, similar to the exchange control system, largely deriving from the same historical forces. The most strict type of control covers basic consumer goods as well as key intermediate inputs and motor vehicles, whose prices can be changed only with prior ministerial and Cabinet approval. The next group of goods are also strictly controlled but require only ministerial approval. A third group provides for approval by the Ministry of Trade and Commerce of the pricing formula, which can then be applied to change prices as needed. A fourth group of essential and popular consumer goods are subject to maximum mark-ups at the wholesale and retail level. Finally, there is a fifth group covering all other goods for which the mark-up is limited to that which existed in December, 1981. Goods escaping price control include export goods, items sold at public auction, second hand goods and a few other categories of commodities.

2.F. Fiscal Policies

The fiscal deficit is a key part of the macroeconomic framework and affects trade development in several ways. Improved public savings and less recourse to public sector borrowing are necessary if investment is to rise without pressure on the interest rate and/or external borrowing. The First Five Year Development Plan recognizes this requirement and sets a goal to reduce the budget deficit from 10% of GDP in 1985/86 to 6% in 1990/91. But there has been no trend to reduce the deficit since Independence. As long as this continues, fiscal policy cannot be used adequately to manage the economy through indirect controls. It also means that a much larger burden is placed on the exchange control system (as well as price and wage controls).

The expenditure strategy has involved heavy public investment in improving the welfare and human capital of the population, as well as reorientation of agricultural services towards small holders. But the benefits from this strategy will accrue only over the long run, while the costs appear immediately. Given the policy of holding down external resource transfers (capital inflows) these large deficits reduce the share of national resources going into private investment at the same time that private savings has risen (going into public investment on top of public savings through taxation).

Typically there is less room to operate on the deficit through tax increases than through expenditure cuts. The historical rates of taxation are high and leave only some room to increase efficiency of tax collection as well as expand the base and raise the rates. Parastatal losses are one area where Government can seek recourse to cutting expenditures. Improved management and divestiture as well as reduced explicit subsidies through parastatals are options which can make substantial cuts in public expenditures. This is a difficult part of the macroeconomic package to reform because it is so visible and direct in its impact on those taxed and those subsidized, each having intense interests in changes made.

2.G. Financial Sector Policies

Both interest rates and credit allocation stem directly from financial and monetary policies. In Zimbabwe there is no intervention in the allocation of credit to the private sector and short-run monetary management by the Reserve Bank has maintained stable nominal interest rates. Financing of the fiscal deficit has come through a diversion of investment from private to public uses, rather than through monetary expansion and resulting inflationary pressures. But it is this "crowding out" effect of a combined responsible monetary policy of restraint and a high fiscal deficit which slows investment in the private sector. Growth of job opportunities and the ability to take advantage of external opportunities to export both suffer in a tight credit situation. It must be remembered that investment policy and approval criteria add to constraining investment decisions, as does the lack of foreign exchange for expansion purposes. A loosening of credit availability and more credit flows to new and non-traditional borrowers and sectors will be necessary if the growth targets are to be met.

2.H. Other Policies

Agriculture is the foundation of the economy, with over 70% of the population living in rural areas and deriving their livelihood from farming. In addition, the growth of the economy is largely conditioned by the performance of the agricultural sector. In addition to providing more than 90% of all food requirements, it accounts for some 41% of total merchandise exports. Thus meaningful development must place the agricultural sector as one center piece of development strategy. The Five-Year Plan calls for agricultural output to grow at 5% per year, which is well above the projected average rate of population growth of 2.76%. This level of output would enable the country to increase its export of agricultural products by 6-7% annually and also to increase the processing of agricultural raw materials. Employment in the agricultural sector is expected to grow by an annual rate of 2.2%, mainly in sub sectors using labor-intensive production techniques such as horticulture.[1]

The technical potential for future growth of agricultural output is considerable and there are many possibilities for increasing agricultural output through the introduction of new crops. But acceleration of the growth of agricultural output is likely to require further capital investment, including injections of foreign exchange to allow farmers to replace old capital stock. Also if agricultural growth is to be widespread and benefit the majority of the population, then the geographical patterns of production will need to change and shift increasingly toward the communal areas. These areas are not developing nearly as well as they could, if they had greater access to improved support services, marketing and input delivery systems. Price incentives for both modern and traditional farmers will have to be maintained at adequate levels and the problems of land use, distribution and marketing will have to be solved.

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[1] Republic of Zimbabwe, <u>First Five-Year National Development Plan - 1986-1990</u>, Volume I, April, 1986, p. 25.

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