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SADCC REGIONAL TRADE ISSUES
(Internal Memorandum to USAID/Zimbabwe)

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Introduction

The USAID/SARP office in Zimbabwe commissioned the services of a private sector consultant to assess the various trade promotion options previously presented in regional studies prepared for both USAID/SARP and the Southern Africa Development Coordination Conference (SADCC). The purpose of this research was to review the various trade promotion options presented in terms of their potential impact on expanding trade and increasing export earnings within the SADCC countries. Additionally, the administrative and functional viability of the options presented was reviewed. To complete this scope of work, a series of interviews with various private sector businesses, banks and government agencies in several countries were conducted over a 10-day period.

This report presents the findings of this research in a summarized format, as well as a separate writeup in memorandum form of each interview conducted. This report expresses the personal observations and opinions of the writer and is meant to be used as background information and internal use for consideration in preparing a project concept paper.

Each country within SADCC has its own particular set of economic problems. This report will not repeat the country information previously provided, but there is agreement with the conclusions and statements in the IMANI report as a number of the issues raised in that report were discussed and the results confirmed.

Findings

- The intra-regional trade issues and their impediments are, in fact, closely interrelated to the international trade issues confronting each country. Some separate problems exist, but in many cases the impediments affecting intra-regional trade also affect international trade. The prime example of this would be the poor transportation infrastructure within the region and the high cost of getting all trade goods to market.

- The findings of this research found a number of common elements within the trade problems and trade promotion requirements of each country. These include:

A) Trade barriers for both the import and export of trade goods have been established by independent government policies within each country.

B) There is a common shortage of adequate foreign exchange reserves in most SADCC countries. The main exceptions being Swaziland, Lesotho and Botswana and, even in these countries, foreign exchange inflows are not totally the result of positive trade flows.

C) Transportation and port infrastructure problems are common throughout the region and greatly affect the cost and competitiveness of all products being traded. Import costs are increased and export prices often rise to a level of non-competitiveness in the world market.

D) There is an inability of local producers to competitively price their products. This is a result of the government policies and transportation problems cited above.

E) Production capacity is well below normal in most countries. This, again, is a result of trade restrictions, size of domestic markets and lack of foreign exchange availability for the purchase of raw materials and spare parts.

There is a shortage of skilled and experienced management which negatively impacts the efficiencies of production.

-The overall investment climate in each country visited varied considerably and was in general very negative. Nationalistic policies are a primary cause for the disincentive for new capital investment. Swaziland was the only positive exception to this situation and is more a result of the uniqueness of its geographic location than a complete liberalization of investment policies.

- The overall dominance of South Africa, both in terms of a producer and supplier of raw materials and as a purchaser of export goods, was most apparent. Additionally, many of the major companies operating in both the industrial and agricultural sectors in these countries are, in fact, subsidiaries of South African companies.

- It was obvious that most of the economic decisions affecting trade flows in these countries were being driven by nationalistic political decisions. There was a very definite pattern of government regulatory structures, import licensing restrictions and intra-regional trade policies, including the unacceptability of local currencies, which reflected a predominance of national decisions as opposed to regional cooperation.

- The region demonstrated a number of common problems as regards their economic viability and potential for trade growth, including:

A) The region consists of a large number of economically "small" countries.

B) The level of economic development varies among the countries.

C) Trade patterns and production of certain goods tend to be dominated by one or two countries. The majority of production is primarily agricultural products.

D) Virtually all countries are required to import capital goods from outside of the region.

E) Major exports outside the region are predominantly agricultural products which are subject to world market pricing.

F) All economies were closely tied to the South African economy.

G) A certain level of mistrust exists among the various countries in the region.

H) Immediate macro-economic issues and decisions override governmental long-term planning for trade development. This would include the need to balance current accounts, the structural problems caused by the lack of foreign exchange reserves, the setting of artificial exchange rates and the requirement to settle all trade accounts in foreign currency.

- There will need to be a series of high-level policy changes within each government to overcome the existing level of nationalism and remove trade disincentives in order to move the region towards a common market approach to trade development. Currently, markets are not defined by country or geographic location, but are the result of trade restrictions and transport costs within the area. This implies that the priority for policy change should be in (1) improvement in intra-regional transport systems, and (2) regional cooperation required before any benefits will be obtained from intra-regional trade. Trade policy changes must include the agricultural sector and cannot be dominated by orders to increase industry exports to the detriment of domestic production.

Pre-financing, Credit and Investment Funds

The research papers presented to USAID recommended the creation of a series of financial arrangements and funds to promote trade activity. These funds include an Export Pre-Financing Revolving Fund, an Export Credit Fund and a Cross-Border Investment Fund.

Export Pre-Financing Revolving Fund

The concept of this fund is to provide foreign exchange access for the necessary purchase of raw material and spare part components which must be imported in order for a company to produce its product. This product could be for domestic consumption, as well as for export. However, the driving rationale for the fund would be to provide access to this foreign exchange for those companies which are in fact net export earners. The concept of this fund was well received in virtually every country visited and the mechanics for its creation were discussed at length.

The major problems in creating such a fund include:
A) the ability to replenish the fund with foreign exchange earnings and make such a fund revolving, B) the actual

administrative burden to operate such a fund either through a new institution or through existing commercial bank or central bank facilities within each country, C) the need to work with each government to obtain the necessary agreement for the operation of such a fund within a particular country.

The general consensus of the desirability and usefulness of such a fund was most positive; however, it is apparent that such a fund could not be operated on a truly regional basis at this time. The main impediment to a regionally structural and centrally controlled fund is again the need to deal and reach an operating agreement with each country's Central Bank. Given the diversity of national policies and individual government systems, each agreement will have to be negotiated separately and will most likely differ in such areas as:

A) The percentage and mechanisms allowed for exporter retention of foreign exchange earnings.

B) The percentage of foreign exchange allowed and timing for repayment (or repurchase) to the fund by the exporter.

C) The use of the local currency held by the fund during the period that exists before total repayment (or repurchase) to the fund in foreign exchange.

D) The process involved in approving application for the use of the fund by any local company. The decision must be made as to which type of companies shall have access to this fund (large, small, only net exporters, industry or agricultural, foreign or domestic ownership and intra-regional or international sales base).

A lean central administration of the fund can be created as long as the actual operations are conducted on a national level.

The Export Credit Fund

It has become apparent through research that the need for an export credit fund is not of the same level of priority as a pre-financing fund for the purchase of imported raw materials. An export credit fund would be necessary only in the context of intra-regional trade where the economic problems of particular countries would require extended credit terms for an importer. When combined with the foreign exchange problems of these countries and the desire by all SADCC countries to earn immediate foreign exchange, such a fund would not generate the necessary foreign exchange because all imports and exports would be strictly intra-regional. The importing country would be a net foreign exchange loser. In theory, the PTA Trade and Development Bank would be the proper vehicle for providing this type of credit extension among the countries in the region.

Cross-Border Investment Fund

The Cross-Border Investment Fund concept was well received in Swaziland, Malawi and Mozambique, all of which would be recipient countries of new joint venture investment. However, this fund appears to be extremely difficult to properly structure and administrate due to the different investment policies in effect in each country. It appears that most countries will not allow local capital to be converted into foreign exchange only to be subsequently invested in another country. This is considered to be a loss of capital (in which the "exporting" country receives no benefit).

There is considerable difference between the need for cross-border equity investments as opposed to the need for financing the import component of any new project or business created. The creation of such a cross-border investment fund is in reality assuming the role of an intra-regional development bank and the problems associated therewith. It also appears obvious that there would be a rather one-sided flow of funds in the region as Zimbabwe businesses look for alternative routes to free-up frozen local currency. The question of expanding their base outside of Zimbabwe and thereby creating a multiplicity of channels for earning foreign exchange appears to be in conflict with many established government policies. This is particularly true in the case of large multi-national companies which could easily utilize this fund and outside investment to increase their percentage of repatriated (held offshore in convertible currency) profits. One must ask why these companies are not expanding and diversifying their local investment base before attempting to invest inter-regionally.

Given the number of variables and the complexity of this type of financial arrangement, it is questionable whether USAID should become involved or has the technical expertise available to properly control such an enterprise. The beneficial aspects of the use of such a fund, however, would warrant further in-depth study of the creation of the cross-border investment fund and whether or not USAID can perform a positive role in its creation.

The Role of USAID

The desire of USAID to become involved in trade promotion activities and allocate resources towards the creation of financial funds which would enhance regional development is understood and is a positive role for the Agency. However, there are a number of problems, pitfalls and questions that USAID should be aware of and ask before committing to any specific program.

-- Is it a proper role for USAID to effectively replace or enhance the normal function of a country's , central bank? The creation of a fund which will provide access to foreign exchange by private sector companies has a positive immediate effect for the company, but does not address the cause nor provide the solution for the underlying structural problems which have caused a foreign exchange shortfall to exist.

-- The creation of funds which would give access to immediate foreign exchange availability may not be the best utilization of developmental funds as the return on this money will be delayed over time. That is, the funds will be drawn down, either purchased by or lent to private sector companies at one time; any repayment will be subject to the actual production, trade cycle and repayment in foreign exchange to that company for sale of its products. Only if the funds are made available to companies who are net exporters and foreign exchange earners is there any possibility that the fund itself could be replenished. The question arises then, is it more important for the fund itself to be revolving and therefore show long-term viability, or for the underlying user of the funds to be successful? There is a strong need for the import component requirements of domestic production companies to be financed as well, particularly in the context of overall economic development within the country.

-- The involvement of USAID in trade promotion activities at this level is actually an involvement in areas of macro-economic policy and it would appear that significant policy reform at the government levels shall be implemented if the use of USAID funds is to truly provide a structural resolution to the problems. Is USAID actually becoming involved at a level which is more properly the role of the IMF or World Bank?

-- The ability to create and operate a centralized and regional fund for all SADCC countries as opposed to a series of national funds appears to be most difficult at this time. This is because of each country's independent and nationalistic outlook toward its own trade and economic development. It does not appear possible that any fund could be operational without the total agreement of the various ministries of trade and central banks involved. At the very best, the creation of a regional fund which is available for each country and subject to a series of national-level agreements and utilization could be possible. The actual regional-level administration could be minimal and, at best, consist of a committee made up of AID personnel and SADCC representation. Actual operations would be carried out on a national level, case by case.

-- Given the size and complexity of the economic problems in each of these countries, the monetary level of any fund to be created would, in fact, be quite high. As a result, it is possible that the best fund organization would be that with a multi-donor structure. USAID would fund a significant portion, but not the total of any such fund.

-- There is considerable doubt as to whether the creation of these funds at the levels requested could, in fact, be properly administered as a revolving fund. It is perhaps more desirable that they be structured as a combination of revolving funds from certain strong companies and non-revolving from smaller, illiquid companies. The requirement to make any fund self-sufficient and viable over a long timeframe places considerable restrictions on its operation and does not truly alleviate the foreign exchange burden of each country.

Recommendations

- USAID/SARP should have a pro-active role in the initiation and implementation of further in-depth feasibility studies on trade promotion issues; particularly for the Export Pre-financing Fund and the Cross-Border Investment Fund.

- USAID/SARP needs to assess the need for and qualifications required for both short-term and long-term technical assistance involvement in the creation and implementation of any trade related projects.

- USAID/SARP needs to insure that actual trade related projects and financing mechanisms are compatible with bilateral USAID programs.

- USAID/SARP should carefully study the needs for and opportunities for effecting basic policy changes as an integral prerequisite for project implementation.

- Given the various development constraints and problems identified above, it is recommended that USAID strongly consider designing its trade promotion project as follows:

> A grant-funded, non-tied Regional Commodity Import Program which would be jointly administered with the SADCC Secretariat and would operate on a national level with individual allocations within each country. The local currency generated from this non-revolving fund would be dedicated toward the local cost component of regional transportation development projects.

APPENDIX

The following call reports are written as independent memoranda of each visit made in the region. These visits provided a valuable base of knowledge for the writer and each helped solidify opinions regarding USAID trade promotion activities and particularly the need for and operational problems involved in the creation of the proposed financing mechanisms.

Location: Mbabane, Swaziland   Date: 7/14/87

Company: Central Bank of Swaziland

Person Contacted: Mr. H. B. B. Oliver, Governor

Met with Mr. Oliver who is the Governor of the Central Bank of Swaziland. He has been Governor for approximately 3 1/2 years, although he was a senior staff member within the central banking system for a number of years before that. Mr. Oliver helped to design the PTA Clearing House system. Mr. Oliver agreed that the PTA Clearing House is not working efficiently at this time mainly because foreign exchange settlement requirements are being required in too short of a time frame (every 60 days). He did emphasize, however, that he felt more importantly the weakness within the PTA clearing system was the high local content requirement for products being traded, as well as requirements for local shareholding and local country value-added for the list of goods that could be traded. In other words, the requirements of origin of goods was so stringent that actual trade through the PTA system was very difficult. He noted the similarity in products traded as well as the traditional trading routes did not augur well for increased intra-SADCC trade.

We discussed the position of Swaziland and its growing export market which he described as being virtually 100% exports to Europe or to South Africa. He stated that Swaziland relies on South Africa not only because of geographical location, but because (1) the majority of Swazi companies have South African ownership and/or interlocking director relationships; (2) the import side or import component for Swazi production is being covered most efficiently by South African suppliers; and (3) the transport systems through South Africa, while more expensive, are much more reliable.

He commented on some of the structural problems associated with the fact that Swaziland exports tend to go through one port, while a variety of their inputs come through different ports and even road transportation. This causes an inefficiency in the usage of rail transportation, for example, as it tends to come back to Swaziland with less of a load. Mr. Oliver discussed the traditional rail link with Maputo and agreed that, ideally, Swaziland should use this port much more often. The main problem is, in fact, the security on the rail line and the inefficiencies in the port itself. Since the late 1970s Swaziland has been utilizing a newer rail link to Durban, South Africa as insurance to its traditional link through Mozambique.

Mr. Oliver was somewhat opinionated that any USAID assistance within the southern Africa region should take into consideration the similarities of the region to that of Europe after World War II. He emphasized the similarity of no convertible currency in both cases and that the United States plan for Europe, i.e., the Marshall Plan, would probably be effective in this region as well. He felt that the Marshall Plan was an important mechanism which allowed Europe to create the ECU and reminded us of the number of years that it has taken Europe to recover since the end of the war and that the southern Africa region would have somewhat the same timeframe for development.

Location: Mbabane, Swaziland Date: 7/15/87

Company: Ministry of Commerce, Industry and Tourism

Person Contacted: Mr. Chris Mkhonza, Principal Secretary

We met with Mr. Mkhonza, Principal Secretary for Trade, in Swaziland who gave us a brief but useful background as to Swaziland's position within the region, as well as its membership in the PTA. He stated that Swaziland, with its extremely small domestic market, joined the PTA system for export reasons. Virtually all of its production in basic products, i.e., sugar, timber and fruit, is provided for export. Swaziland, again because of its small size, does not appear to be a competitive trade partner if it were a strictly independent exporter. The country belongs to the SACU, as well as the PTA, and is able to benefit from this linkage through trade with South Africa. Again because of its membership in the SACU, Swaziland receives a percentage of the funds generated through customs duties and other tariffs for the whole region and this source of revenue is, in fact, almost equal to its total export earnings.

Mr. Mkhonza stated that the foreign exchange situation in Swaziland is not a finacial problem as much as a mechanical problem as it relates to import permits and other non-tariff trade barriers. The actual impediment to trade is more the issuing of import permits and timing of the allocation of the foreign exchange, although Swaziland does not lack for foreign exchange reserves. He emphasized that actual trade in Swaziland tends to be on a case by case basis without any truly coordinated approach. The PTA tries to achieve this through its commodity list, but the other regulations involved in PTA trade are a disincentive to Swaziland. In discussing intra-regional trade, he pointed out that there is a bit of trade among the region; however, on the import side, the competition with South Africa makes the other countries non-competitive. The transportation costs to ship Swazi exports to other SADCC countries also adds considerable cost to their product, as well as repayment terms requested by the other SADCC countries make it very difficult for a Swazi exporter to shift his market.

Mr. Mkhonza discussed the recent increase in investment in Swaziland by foreign companies and stated that the actual number of companies now operating is not as great as the statistics would imply. He stated that a number of countries which have been operating in South Africa have, in fact, applied for and opened corporations in Swaziland, but these are, only "P.O. Box" companies as these corporations have not totally pulled out of South Africa as yet. He says the move by these companies is an insurance against possible future events.

Swaziland does not provide investment incentives in terms of tax holidays, land acquisition, or dividend remittance. Although new investment is growing, it is at a much slower pace than some people have stated. One positive example, that he did emphasize was the Coca-Cola concentrate plant which has moved out of South Africa totally and is now operating regionally in Swaziland for the region. He stated that the Coca-Cola plant will be the single largest corporate taxpayer in the country, as well as providing employment for several hundred people. Another example was an orange juice company which moved operations into Swaziland because one of its main inputs, sugar, was cheaper there. A problem this company encountered was protectionism in South Africa as it attempted to re-import its product to its traditional market and received complaints from South African competitors.

During the course of the discussion, Mr. Mkhonze did agree with the basic comparison of Swaziland to Singapore as Swaziland is becoming a similar country in terms of being a value-added "trading post."

When asked about the transportation systems and the utilization of Maputo as opposed to South Africa, Mr. Mkhonze stated that the problems included (1) security along transport routes; (2) inefficiencies at the port itself which include warehousing inefficiencies which led to losses of product, particularly food products; and (3) the ship schedules were unreliable because of port charges and inefficiencies at the port. The shipping lines themselves did not schedule Maputo on a regular basis. He agreed that it made economic sense to ship to Maputo if all other factors were equal and that if could depend on the port. However, they are continuing to deal with South Africa "out of necessity."

Mr. Mkhonza was quite interested in the proposed structure of the export pre-financing fund but felt that it was not particularly necessary for Swazi companies since foreign exchange availability was not a major problem at this time. When we began to discuss and explain the cross-border investment fund he became somewhat confused and said to the effect that this fund would not be needed because Swaziland was open to all investment and that a number of companies have already established operations without utilization of such a mechanism.

Location: Mbabane, Swaziland Date: 7/15/87

Company: Swaziland Industrial Development Company, Ltd. (SIDC)

Person Contacted: Mr. Scott Reid, Head of Investment Promotion

The Swaziland Industrial Development Company (SIDC) is an interesting company which is in evolution at this time. The SIDC is a parastatal company which has assumed the assets of the now defunct National Development Industrial Company and is in transition toward becoming a private sector corporation. Because of the value of the assets retained, the government will receive a 30% ownership in the SIDC. Other shareholders include the CDC, the IFC, the Netherlands Development Organization (FMO), Barclays Bank and Standard and Chartered Bank. These companies have invested a total of 30 million rand as risk capital in the SIDC for which there is no guaranteed return. The role of the SIDC is to act as a catalyst within the country and make long-term equity and developmental loans to Swazi corporations. Although the SIDC is limited to financing Swazi projects, it was interesting to note that no direct Swazi equity is necessarily required in a particular project.

Mr. Reid is a Canadian citizen who has been involved in this project for some time. He stated that the biggest problem that they had has been the ability to attract qualified technical staff, as well as local project managers. Mr. Reid stated the SIDC has now organized its work for the rehabilitation of the various Swazi projects that they inherited from the NDIC and they are just beginning to study new projects for which they may either take an equity position or make a long-term loan. The SIDC must be less than a 50% owner with a limit of three million rand in investment on any one project. They are not interested in becoming the managing partner of any particular project that they finance.

We discussed the concept of a cross-border investment fund and Mr. Reid was quick to point out that they are looking at several projects which involve investors from Zimbabwe, as well as South Africa. One of the main reasons that a ceramin manufacturing project has not moved forward is exactly the rationale for the creation of the CBIF; that is, that the Zimbabwe corporation cannot convert its local currency to make an investment in Swaziland. It appears that they will have to work out some mechanism of delayed payment through the capitalization of management fees to credit this investor with its equity.

Mr. Reid was quite candid that should a CBIF mechanism be created that the SIDC would be a good vehicle in which to administer such a fund in Swaziland. They would indeed be a qualified agency to assess a particular project and administer the final flow mechanisms entailed in such a fund. He was quick to realize that although the CBIF would work in theory there would still be a cash flow timing difference between the payment out of foreign currency and the replenishment of such a fund from dividend flows. He stated that the SIDC would again be a good vehicle for the short to medium term utilization of local currency that the fund would have from time to time. He did question how any regional fund would be able to work when, in fact, the PTA Clearing House does not work, and felt that any such investment fund would have to be done on a case-by-case basis within a particular country.

Mr. Reid also discussed some of the weaknesses of the PTA and its regional approach. He felt that the overall region is so weak that Swaziland stands out because of its excess foreign exchange reserves. The PTA problems are much more severe in the areas of criteria for local content and value-added within a particular country than strictly the mechanisms of the Clearing House. He stated that in order to reduce tariffs on an import into Zimbabwe, for example, a Swazi product would have to have 50% local content or 45% value added in Swaziland. This is a very difficult position for Swaziland, again because its domestic market and production is so small. He stated that this is one of the reasons that the PTA or SADCC region is not the main market for Swazi products. The USA and the EEC are much more accessible and "easier" to work with.

Location: Industrial Park, Swaziland Date: 7/15/87

Company: CONCO (Coca-Cola Company)

Person Contacted: Mr. Ed Ettinger, General Manager

Through an appointment arranged by Mr. Mkhonza, we were able to meet with Mr. Ettinger, the General Manager of the Coca-Cola concentrate plant which has recently opened in Swaziland.

Mr. Ettinger, an American citizen, was quite candid as to the reasons for Coca-Cola moving its operations to Swaziland. He stated that disinvestment from South Africa under "extreme pressure" from Coca-Cola U.S.A. was the driving force to move the operation. As a result of the move, the company was reorganized as CONCO, Ltd., as a Cayman Island corporation. Previously, while operating in South Africa, the company was part of Coca-Cola International where tax payments to South Africa tell under a reciprocal treaty with the U.S. It is to the company's benefit now to have all internationally earnings from CONCO passed to the Grand Cayman and re-utilized in other operations of Coca-Cola before final repatriation to the U.S., therefore, payment of U.S. taxes.

Mr. Ettinger explained that various countries within the region had their own bottling plants and that CONCO would provide the syrup concentrate to each plant. However, he was quick to point out that over 90% of their sales would continue to go for South

African consumption. This has been their traditional market and it will be retained. They also ship to Zambia, Malawi, Botswana, Lesotho and Swaziland and, occasionally, to Mozambique. There is a concentrate plant in Zimbabwe which they would eventually like to supply from this operation, but he is already aware of the foreign exchange problems of working with this plant.

We discussed how he was operating with the bottlers in these other countries and he advised us that because of the intercompany relationship between their concentrate plant and the bottlers they are shipping on open credit terms directly and are not utilizing the PTA clearing system. They have never had any major payment problems, although he did admit that he is starting to see problems with Malawi which traditionally paid within 2-3 months, but is now over six months past due. Mr. Ettinger explained that because of the size and strength of the company they are able to carry these receivables for quite some time, particularly since they do not amount to a significant portion of their total sales. He was quick to point out that sales to South Africa are, in fact, paid virtually immediately (ex-doc) and their cash flow is therefore quite positive.

Mr. Ettinger responded to our questions regarding Swaziland in a very positive fashion, stating that the infrastructure and local business climate was very good. The company is able to do business with the rest of the world, but is still utilizing South African transport systems for the same reasons as other Swazi companies. The product is shipped by truck and the road system to Johannesburg was considered excellent. He stated that his main problem was the ability to establish this operation and quickly settle his expatriate staff members. He stated that while several of the government departments regarding foreign investment are excellent, the support services for housing and schools were terrible. There are nine expatriate families working for the company since last October and there are still five of them without permanent housing. Local housing is virtually unavailable and they are having difficulty in obtaining land to build housing of their own. Lastly, he stated that the corporate tax rates were quite reasonable and that, in fact, it is less than the 50% rate previously charged by South Africa. He has had no problems to date importing machinery, equipment or parts that he has brought in to complete his operation.

Location: Manzini, Swaziland Date: 7/15/87

Company: Swaziland Chamber of Commerce and Industry

Person Contacted: Mr. J. L. Ayton, Secretary

We traveled to Manzini to meet with the Swaziland Chamber of Commerce and after considerable searching found the office in the back of an automobile spare parts shop. The office condition of the Chamber reflected its extremely weak monetary position and implied that the organization had virtually no expendable funds. Mr. Ayton has been in Swaziland for a number of years and was previously the manager of the Libbys canning plant in the country. He is now retired and works for the Chamber as a volunteer several hours a day.

Mr. Ayton was quite open to discuss with us what he felt were a number of trade promotion activities which need more support and work. He pointed out that because of Swaziland's size and location it actually has no other alternative but to maintain a positive relationship with South Africa. He stated that Swaziland was truly a village and really could not do anything else. As a result of this relationship, the trade patterns have grown accordingly and Swaziland's chief exports of sugar, as well as canned fruit are most often sold directly to South Africa.

He described the Libbys canning plant, which is now owned by Nestle, as the country's major national industry. They now can over 45,000 tons of pineapple and some 50,000 tons of a variety of other fruits, including grapefruit for export. The company employs some 2,500 people. Mr. Ayton stated that virtually all sales of this plant go to the EEC, although South Africa does take a small portion. Additionally, wood pulp is shipped overseas and to South Africa. He commented that the country has virtually no real marketing problem as it can sell all that it produces and that most new industries are, in fact, working as a value-added production and re-export operation. The textile industry is an example of this, although there is a move to fully integrate the production from raw cotton through the finished product within three years.

Mr. Ayton stated that so far trade with the SADCC region is a problem as compared to a virtual trouble-free EEC market. The transport, communications, and payment systems of international export have been no problem and Swaziland is well within established quotas for various products that they export to both the U.S. and the EEC. He again pointed out the problems with shipping through the PTA system and stated that Swaziland cannot meet the local component nor shareholding requirements when most companies are controlled by multinationals who will not give up ownership for marketing purposes; particularly since there is no lack of buyers for products being produced now.

Mr. Ayton described the Swaziland Chamber of Commerce as being an organization that is growing slowly, but has a very important role to play in the continuing development of Swazi Industry. He felt that with any program that AID would initiate in Swaziland in the private business sector that the Chamber could make a contribution and would cooperate with AID as they could. It was nonetheless obvious that the Chamber needed increased financial support primarily from its membership and possibly technical assistance in the long run.

Location: Maputo, Mozambique   Date: 7/16/87

Company: Chamber of Commerce of Mozambique

Person Contacted: Mr. A. Mabuiangue, International Relations Dept.

Mr. Alesandori was not available when we arrived for our appointment and we met with an assistant trade officer, Mr. Mabuiangue who, unfortunately, was not terribly knowledgeable about the subject matter. We discussed various aspects of the Mozambique economic situation and the trade patterns that had developed through South Africa by the other SADCC countries because of problems in Mozambique. The conversation unfortunately, was rather one-sided and Mr. Mabuiangue was unable to provide much information or insight into the Mozambique situation. He had little information when asked. He stated that most of the investment and trade decisions that we began to discuss were the purview of the Investment Board and the Ministry of Trade. The Chamber of Commerce itself appeared not to be terribly active in trade matters. This of course would be the result of the centralized state system of Mozambique. All in all, a very disappointing call.

Location: Maputo, Mozambique Date: 7/16/87

Company: Comphania Nacional de Exportacao (ENOCOMO)

Person Contacted: Mr. K. Patel, Marketing Director

We met with Mr. Patel, the Marketing Director for the State Agricultural Trading Corporation. This company purchases virtually all land grown agricultural production from the small producers, as well as larger commercial farmers, and is responsible for the sale and export of these commodities. As a state-owned company they are also now involved in the importing of certain commodities due to crop shortfalls in the domestic market.

Since 1984, approximately 60% of all Mozambique export revenues have been handled by ENOCOMO. The main production crops which they are handling are cotton, sisal, copra, sugar and coconut oil. There is a separate marketing board handling tea production and export.

Mr. Patel explained the reversal in the sugar production has had a most debilitating effect on the Mozambique economy. The country used to produce 90-100,000 tons annually and production has now decreased to slightly less than 40,000 tons. Over 50% of the production capacity has been lost through sabotage both by the burning of cane fields and the destruction of sugar refining factories. In 1985 they spent 12 million rand rehabilitating two factories which were refining almost 60% of the country's production and in late 1985/early 1986 the factories were again sabotaged. While the factories now are in operation, the country is still paying the debt on the rehabilitation cost.

Mr. Patel discussed the state of the farming sector and emphasized the current movement toward privitization of these farms. He was aware of USAID small farmer aid programs for input for equipment and there is greater liberalization in allowing this production to be sold privately. He believed that it was better that AID provided this type of direct assistance to the farmer than to work on a larger scale with the Central Bank for the stabilization of their foreign exchange position. Nonetheless, he stated that there is a very definite problem in the agricultural sector because foreign exchange is not available for inputs and this has caused a decrease in production. He described this as an integral part of a vicious cycle in which production decreases and not enough is available for domestic consumption nor for export. Therefore, food imports increase and foreign exchange reserves decrease and further inputs cannot be purchased.

We discussed the pre-export financing fund and he was most enthusiastic that this was a program that would be most useful for the country. He sees the administration of such a fund as a central government role, but does agree that it could be administered by ENOCOMO directly. In fact, the company (ENOCOMO) has begun to experiment with a similar type of operation utilizing some $50,000 in export earnings that they were able to retain directly from the Central Bank. They have provided foreign exchange for a cotton farmer to import fumigation machinery and fertilizer for some 150 hectares of land. This operation has proceeded rather smoothly and the farmer has to date utilized some $25,000 of this fund and his production is increasing expeditiously. Mr. Patel felt that such a fund should have enough resources to provide somehwere in the area of $250-300,000 for similar projects within the agricultural sector. Additionally, he advised that ENOCOMO has formed a joint venture with a Swedish private sector company which is doing somewhat the same function with a small industry. The Swedish partner provides the foreign exchange funds for importation of equipment, as well as technical assistance, and has entered into an agreement to repurchase production.

Mr. Patel discussed quite openly some of the infrastructure and organizational problems within Mozambique. He states that although it was important to dredge the harbor and make the port of Maputo more accessible, the actual operation of the port and its warehousing and labor problems were also very significant. He also cited a lack of middlemen or freight-forwarders within the system at the harbor. He stated that ENOCOMO actively acts as a middleman buying the product and taking the risk to sell the product to foreign markets. Although they have been profitable in this operation he is quick to acknowledge the difficulty of exporting from the Maputo harbor.

Mr. Patel listed the areas which he felt were the major impediments to trade from Mozambique. When questioned about this, his outlook was "gloomy". He listed as impediments (1) sabotage of products and goods while being transported; (2) lack of foreign exchange; (3) lack of operational farming equipment and spare parts for machinery; (4) the high cost of oil and fuel imports for which Mozambique must depend on South Africa to a much greater extent than should be necessary; and, lastly, he cited lack of skilled management, efficient organization and labor training.

Location: Maputo, Mozambique   Date: 7/16/87

Company: Banco Standard Totta de Mozambique

Person Contacted: Mr. B. S. Parente, Director

Mr. Parente received us most cordially as we had no scheduled appointment with him. As the Standard Totta Bank is the only remaining commercial bank operational in Mozambique I felt it was important to meet with them.

The Standard Totta Bank is a joint venture bank, 30% owned by Standard and Chartered and 30% owned by Banco Totta Azores, with the remaining shareholding divided among several international commercial banks. The bank is in an incredible position of having been virtually shut off from all foreign exchange transactions since 1977. Its foreign exchange license has been cancelled and the function of international trade financing has now shifted to the Bank of Mozambique which is operating as a combined central bank and commercial bank. The Standard Totta Bank has access to a worldwide network of correspondents through its shareholding group but is unable to utilize this network without the foreign exchange license. Mr. Parente said that there are some signs that they may be able to operate in a limited fashion in the future, but to date no action has been taken and no official decisions have been made.

As a result of losing its foreign exchange license, the bank has been virtually dormant since the late 1970s. Much of its trained staff left the organization and up until 1981 they were not allowed to hire new staff. Since that time Mr. Parente has found that it is very difficult to find any new qualified staff with a strong banking background. Additionally, the bank is unable to offer any of the incentives that have begun to be offered by other foreign businesses which are include paying some percentage of employee's salaries in foreign currency. The bank has shrunk from a total of 44 branches now down to a level of seven branches in the country.

Even more difficult for the bank is the large amount of local currency liquidity that they hold. Mr. Parente stated that the bank has a liquidity ratio in excess of 300% (cash and liquid investments as a ratio of all earning assets). They have not opened any new deposit accounts in over four years and have had to cease paying interest on deposits. At the same time, their excess liquidity must be deposited in the Bank of Mozambique and they are not receiving any interest on those funds either.

Actual lending activity is minimal as the bank is prepared only to lend to certain "safe" companies and although they are losing money on idle funds feel that the credit risk is too great to justify an increase in domestic lending. One wonders why they have any customer base left at all.

Recently, a decree was passed that deposit rates on accounts would be increased to 12-16% and they are still negotiating with Bank of

Mozambique as to whether they truly have to pay on deposits as this would cause even greater losses to the bank, particularly since they have not received interest on their funds from the Central Bank. He stated that the Bank of Mozambique is paying interest to its other customers, but not to his bank.

We briefly discussed the structure of a pre-export financing line, as well as an export credit facility and Mr. Parente, being an experienced international banker, was very quick to grasp the concepts. He agreed that such a system would be most useful in Mozambique, but was not terribly optimistic that it would be workable given the present level of bureaucracy and inefficiency within the government systems. He stated that Bank of Mozambique cannot even publish its own financial accounts and certainly could not be counted upon to manage such a fund efficiently.

Location: Maputo, Mozambique Date: 7/17/87

Company: Ministry of Trade/Africa Dept., Export Division

Person Contacted: Mr. Sechane, Manager

We met with Mr. Sechane of the Ministry of Trade who advised us that our scheduled appointment with Mr. Novella could not be kept as he was ill.

Mr. Sechane is a senior official in the Africa and Middle East Department of the Export Division of the Ministry of Trade. The Ministry of Trade handles both exports and imports and has divided itself organizationally along these two lines. He stated that the Ministry of Trade is involved in establishing all commercial policy regarding trade, including intergovernmental relations, establishing product lists and foreign exchange mechanisms. Other tariff issues are handled by a customs division, but this is still within the Ministry of Trade.

Mr. Sechane was quite candid regarding various impediments to trade from Mozambique and cited security within the rural areas as being a major concern. He was quick to point out that the transportation system within the country is extremely poor and getting goods to the market, i.e., Maputo or Beira, was very difficult. Most of the goods which go through the ports of Mozambique are not Mozambique products but, in fact, belong to other countries who are landlocked and passing through Mozambique on rail lines to use the port facilities. He cited that Mozambique domestic production had decreased to very severe levels and that they were now importing a number of products that they previously produced in sufficient quantity or even exported themselves.

We discussed intra-regional trade and explained the concept of the export pre-financing fund at which point Mr. Sechane stated that they in fact had established a similar mechanism with Zimbabwe for a certain amount of trade between the two countries. Unfortunately, the trade limits for local products which could be settled in local currency and then ultimately settled with foreign exchange after one year was only the equivalent of $600,000 for each country. This level was much too low and they are now negotiating to increase it later this year. This agreement was strictly between the two governments and individual companies had to apply within the agreement to conduct actual trade. A joint commission is scheduled to meet in August of this year to discuss continuation of this bilateral arrangement and possible increase in the dollar amounts utilized. Meanwhile, with the total funds already used Zimbabwe is extending a line of credit to Mozambique which is to be repaid in new products and as credit against future railway and port charges. When we stated that this appeared to be a positive step forward and was in actuality a rather sophisticated barter agreement, Mr. Sechane agreed and stated that Mozambique had similar barter agreements with Tanzania and Angola, but that these were also official government-to-government arrangements.

Mr. Sechane felt that there was still a need to change attitudes toward working with private sector companies in Mozambique and until changes had been made there would be a continued mistrust of these companies and consequently a requirement to earn foreign exchange directly from any trade transaction. On the other hand, he stated that certain Mozambique companies can retain a percentage of the foreign exchange earnings gained through exports. He did not know the exact percentage but stated that it was a negotiated item on a case-by-case basis depending on the company involved. Mr. Sechane was very bullish on future trade with Zimbabwe as he felt that there was a very wide avenue for growth between the two countries. The products produced by Mozambique were complementary to Zimbabwe, and Mozambique certainly could utilize some of the industrial products and spare parts that Zimbabwe produces.

He was very positive on the creation of an export pre-financing revolving fund and cited several examples where he felt such a fund could be applied almost immediately. He was not as negative about the ability of Mozambique officials to administer such a fund as was Mr. Parente of Standard Totta Bank. One of his main examples was salt production in Mozambique. Mozambique has the ability to produce virtually all of the salt requirement of the region, but is now competing with South Africa for this market because of lack of machinery spare parts and technology to upgrade the quality as well as quantity of production. If a pre-export financing fund were made available, Mozambique could gain export earnings from salt very quickly. We did not discuss the second level of such an export program as regards the lack of foreign exchange in many of the other countries in the SADCC region.

Location: Maputo, Mozambique Date: 7/17/87

Company: Pescom International

Person Contacted: Mr. Felichanto Manuel, Director-General

We met with Mr. Manuel who is Director-General of the state-owned company Pescom International. This company is the centralized marketing operation for all seafood exports for Mozambique. The main product exported through this company is a variety of prawns which are gathered in the waters off central and northern Mozambique. The company coordinates with the state-owned fishing companies which can only sell their product to Pescom International for export.

Mr. Manuel advised us that by far the majority of the product is sold to EEC countries and that because Mozambique signed a trade convention (The Lomec Convention) there is no duty on their product. They have also entered into price agreements and contracts for purchase of specific quantities with France and Japan. Mr. Manuel advised that the actual quantity of production passing through Pescom International now is "small" and that the 1987 total production is expected to be approximately 700 tons. There has been a steady decrease in production since 1984 and Mr. Manuel attributed much of this decrease to the inefficiencies within the state fishing companies themselves. The total production in 1986 was only 500 tons and the 1987 projection could be considered somewhat optimistic.

Mr. Manuel also advised that there are also operating in Mozambique two government/private sector joint venture companies which are operating between the government of Mozambique and Spanish and Japanese fishing consortiums. As he reported that these two consortiums produce in excess of 4,000 tons of prawns annually, it is obvious that the production problems are not due to scarcity of prawns, but inefficiencies in the fishing methods.

Mr. Manuel explained the three fishing companies now operating have a total of seven vessels and are the remains of several private sector companies which were nationalized and reopened by the government as stated-owned companies. The vessels used are [redacted] electrical repair and engine and equipment failures. There has been no foreign exchange allocated to import the needed parts for these fishing vessels.

We discussed with Mr. Manuel the problems of trading with other SADCC countries and used Zimbabwe as an example. He stated that very little of their product is shipped to Zimbabwe for a combination of reasons. Firstly, the price is not competitive in that Mozambique can get top market price for their product in Europe. He also relayed the various problems which seem to be universal among SADCC trading nations, i.e., the lack of foreign exchange and transport problems. He stated that he was aware of some sort of agreement to trade with Mozambique through a bilateral agreement which would allow them to settle in local currency. He was not aware of the details of this agreement, however, and had not seen any direct result of it through his company. He did state that Mozambique does sell a small quantity of dried fish and prawns to Zimbabwe which he estimated to be less than five tons annually.

Pescom International is also involved in the negotiation of various fishing rights which Mozambique grants to other nations and charges fixed fees for a predetermined level of production. He stated, for example, that the Spanish have rights for approximately 800 tons annually and pay a fee of $1,500 per ton. It appears that Mozambique is earning approximately the same amount, if not slightly greater, in income from the sale of fishing rights than they are from actual export earnings from production of their own fishing fleets. Amazingly, Mr. Manuel also advised us that Mozambique actually imports fish for which they pay in foreign exchange. The main fish imported is a type of mackrel from Portugal which is obviously a remnant of the Portuguese colonial times during which these food products became popular.

We discussed with Mr. Manuel various aspects of SADCC and PTA and solicited his opinion on the existing marketing systems. He was not terribly familiar with all of the trade programs available, but opined that the PTA was not working terribly well because Mozambique being a net importer was forced to pay in foreign exchange on credit terms which were not competitive with what they [illegible] could obtain from other areas. He also cited various non-tariff trade barriers which effectively stop inter-PTA trade because of import license regulations. He believed that the trade with Zimbabwe, for example, had decreased from a previous level of approximately $20 million to less than $4 million annually.

He thought that it was a worthwhile task to work on various export incentives, but stated that "everybody else is doing the same." Most of the export and trade promotion that he is aware of was, in fact, being promulgated by EEC countries and as a result there are several bilateral agreements for the purchase of Mozambique fishing products. He felt that a pre-financing revolving line would be a very useful fund for Mozambique and immediately saw it as a method whereby the fishing fleets could be upgraded.

Location: Blantyre, Malawi Date: 7/20/87

Company: Malawi Export Promotion Council (MEPC)

Person Contacted: Mr. J.B.L. Malange, Chairman

We had a very productive meeting with the Malawi Export Promotion Council which is a state-run organization. Mr. Malange chaired a meeting in which virtually his entire staff was present and made a special effort to have various members answer our questions and participate in the discussions as well.

As we began to explain the purpose of our visit and the proposed structure of an export pre-financing revolving fund, Mr. Malange very quickly interrupted and stated that that is exactly the program that he wanted to "sell" to us. He proceeded to describe in detail the many problems currently affecting the various businesses in Malawi and the fact that the foreign exchange position had detiorated steadily over the last 18 months (he was also quick to blame part of this problem on IMF-imposed policies on the Malawi Central Bank).

Mr. Malange explained that the Malawi Export Promotion Council was assisted by the ITC unit of the United Nations and that the council had done quite a bit in the past to promote exports of local products. He advised that his group had assessed a variety of Malawi businesses who had needs for such a revolving fund which he stated initially to be in excess of $80 million. He was discussing non-traditional exports only in the areas of light manufacture, garmets, canned juices and some agrobusiness products such as flowers.

We then began to discuss the predominance of the traditional agricultural sector in Malawi's economy and that the majority of the export earnings were, in fact, from the exportation of primarily products such as tobacco, tea and sugar. He stated that he felt these were large companies who had adequate access to banks and could handle their pre-export financing needs internally. He finally acknowledged that, yes, some of them had a need for spare parts and did have some problems with foreign exchange availability. His emphasis was more in the area of those companies which are now operating at only 40-50% of capacity because of their inability to obtain the foreign exchange component of their production needs.

He obviously was very much in favor of the establishment of an export pre-financing revolving fund and felt that the mechanisms to make such a revolving fund by retaining a portion of the export earnings and passing them back through the fund would not be any problem. He felt quite strongly that such a fund should be established on a national level and that any regional fund would be frought with problems of certain nations dominating the allocation of foreign exchange. When pressed, it became obvious that he was very much worried about the continued predominance of Zimbabwe in intra-regional trade.

Mr. Malange also felt that a cross-border investment fund was a positive idea but felt that such investment did not necessarily have to be in foreign currency. He made a significant distinction between local currency investment in the equity investment versus the capital goods and trading goods necessary for production which would have to be purchased in foreign currency. He also felt strongly that any such investment would have to be created in an area which as geared toward new net foreign exchange earning exports.

Location: Blantyre, Malawi Date: 7/20/87

Company: National Bank of Malawi

Person Contacted: Mr. M.L.C. Mkandawire, Manager,
Economics Dept.

We met with Mr. Mkandawire who had recently been promoted to the position of Manager for the Economics Department of the National Bank of Mozambique. This bank was previously the Standard Chartered Bank in that country and still has strong correspondent ties with that institution. Mr. Mkandawire is a very bright and articulate individual and our conversations were very informative, although they centered more on overall trade and macro-economic issues than the specifics of particular financing funds.

Mr. Mkandawire was of the opinion that it is much too early in the life of many of these countries to be overly concerned about regional cooperation and that the PTA was a good program in theory but, in fact, was operating on premises that were beyond the development of each country involved. He explained that intra-regional trade is not as important an issue as actual global exports for each of these countries as such trade was less than 10% of the total goods produced and traded. He was more complimentary of SADCC and its emphasis on private sector but does not necessarily agree that SADCC should set up or create another organizational body to operate a type of export financing fund. He believes that the most competent manner in which to address [illegible] this issue was through national funds operating through established central banks or commercial banks in each country. He believes that each country's problem and therefore solution is uniquely their own and although lack of foreign exchange is a similar symptom, the degree of each country's economic problem and their method to resolve such problem must be done on a national basis.

In discussing the need for an export pre-financing revolving fund he felt fairly strongly that the emphasis must not be misplaced on new start-up industries just because they are non-traditional. He feels that the best impact is to increase production in that sector which can earn increased export earnings in the quickest time. This would be the agricultural sector of Malawi. He also pointed out that some of the fallacies at looking at non-traditional exporters include a lack of proper definition of the market and market size for their product and whether or not their total production would be truly competitive in world markets.

We discussed the creation of the parastatal marketing corporations of which Malawi has a prime example in a company called ADMARK. Mr. Mkandawire felt that ADMARK knows how to export the bulk product that it buys but does not necessarily know how to channel the actual import components back to the small producers. He also felt that the fund if created needed to define its role as to whether it helps the intermediary marketing company such as ADMARK, or does in fact help the underlying small producer.

We discussed Malawi's problem with transport of its exports. He pointed out some of the economies of scale in shipping the bulk products such as sugar and tobacco for Malawi. One of the problems comes about in that there is a lack of rail cars owned by Malawi to ship their product and as a result when they ship in South African or neighboring country wagons they are forced to pay foreign exchange for such added expenses as freight insurance and car rental. He estimates that between 1984-85 this extra cost was in excess of $50 million. The freight and insurance element of Malawi's imports now account for 40-45% of the landed (cif) value of these imports. This means that a considerable portion of the foreign exchange is absorbed in added expenses to bring products into Malawi. Malawi also has a definite shortage of trucks and as a result is not competitive with other trucking firms as they must amortize the initial import cost of the truck as well as the overall cost to maintain and operate in Malawi. USAID is helping in this area in that new trucks and trailers are being purchased through various programs. He also stated that some work needed to be done on a regional basis to expand automobile and truck assemblies where the product can be brought into the various countries in the region on a concessional basis. He felt that the impact of this type of equipment would be felt in increased foreign exchange earnings, as well as transportation cost savings very quickly.

When asked to list in order of impact the various trade disincentives affecting Malawi, Mr. Mkandawire stated that he felt that the production problem, i.e., low production levels and the transport problem with high costs were equally important and that they both were related to the overall problem of lack of foreign exchange. He further stated that various indirect taxes, tariffs and import duties were adversely affecting Malawi production and export earnings. Lastly, he agreed with our opinion that it appeared that the government and treasury was not taking a long-term view toward resolving its problems and finding true structural solutions as opposed to the short-term approach of cresting incentive to gather present revenues.

Location: Blantyre, Malawi   Date: 7/20/87

Company: Commercial Bank of Malawi

Person Contacted: Mr. Victor Hadrys, General Manager

We met with Mr. Hadrys who is the General Manager of the Commercial Bank of Malawi, along with his chief economist, Mr. Fred Kanjo. Mr. Hadrys is a retired Standard Chartered banker who previously was General Manager of the Zimbabwe office and is now General Manager of the fairly new private sector Commercial Bank in Malawi. The bank was formed in 1970 and has grown fairly steadily ever since. Mr. Hadrys was pleased to mention that the bank had recently paid dividends to its shareholders for the first time and that it was competing well with the National Bank of Malawi for quality business. He stated that the bank was well within its regulatory limits for equity and the 30% liquidity requirement. He stated that credit expansion is now being cutailed as a result of some IMF-imposed restrictions, particularly in the area of government of expenditure.

We discussed various aspects of the Malawi economic situation and Mr. Kanjo participated along with Mr. Hadrys in advising us of what they felt were some of the major problems facing the country today. The primary problem again was the lack of foreign exchange, but they were the first to admit that this was a result of problems and not the actual problem itself. They felt that the foreign exchange shortfall was caused by a number of factors, including high government spending necessitated by security considerations and the servicing of external debt which they stated was "coming to a head" and must be rescheduled. Malawi is meeting its payment requirements but the debt service ratio is still quite high at between 37 and 42% of GDP. Currently, the IMF is negotiating a second stabilization program with the country and is meeting considerable resistance to some of its requirements. The IMF is also blamed for the recent devaluations in local currency.

Compounding the foreign exchange problem is the world market price on Malawi's products. They stated that the price for their tobacco was fairly good due mainly to the quality of the product. However, tea prices are extremely poor and sugar prices were also depressed. Due to transportation problems, Malawi is not competitive in world prices any longer. They also stated that the U.S. recently reduced the quota on Malawi sugar which certainly did not help the country's economic situation. As a result of the foreign exchange shortfall the economy is not able to expand as many companies are producing below capacity. This low level of production is despite the fact that the banks are fairly liquid and the credit demand has only been artificially reduced. The government is setting deposit rates and is following a policy of keeping bank spreads very thin and therefore develop an adversity to lend to less than absolutely credit-worthy companies.

We discussed the creation of an export pre-financing revolving fund as well as a cross-border investment fund, and both concepts were well received by these gentlemen. They stated that the export pre-financing fund would be most useful, however they felt very strongly that any administrative role should be done by the Central Bank and that it was not their role as a commercial bank to become involved in allocation or approval to underlying companies of these monies. They felt that they would be in a position to be severely criticized for favoritism even though they agreed that theoretically they should know their customers best. Regarding the cross-border revolving fund they felt that Malawi was an excellent country for such investment as investment rules were quite flexible, but that any new company operating would be expected to be a foreign exchange earner and that the government would emphasize that aspect in order to gain more foreign exchange liquidity.

In conclusion, Mr. Hadrys felt that USAID and similar donor operations can continue to be helpful and should recognize Malawi for what it is, "a poor but proud nation". He requested that a fund such as the export pre-financing revolving fund be created to "see us through this period."

Location: Blantyre, Malawi   Date: 7/20/87

Company: Investment and Development Bank of Malawi, Ltd. (INDEBANK)

Person Contacted: Mr. David Bishop, Head Project Investigations

We had a very useful but brief meeting with Mr. Bishop of INDEBANK along with one of his assistants, Mr. Chipasula. INDEBANK is a private development bank which has been created through equity investments from four international finance agencies and the state-owned ADMARK company. Foreign shareholders include the CDC, FMO, DEG and IFC. The bank makes long and medium term loans for developmental purposes in the agricultural, tourism and manufacturing sectors. It also operates a subsidiary company which invests in small scale projects. In all cases they are limited to a maximum of 35% equity investment in any project.

The bank receives funds from its shareholders both as quasi-equity for which they pay 8-8 1/2% and from established lines of credit with the World Bank, CDC and European Investment Bank. These lines of credit are in foreign currency and carry a 12-13% interest rate. INDEBANK lends locally at 16-17% and the borrower must assume the foreign exchange risk of the credit and repay any loan in the currency borrowed. Mr. Bishop stated that to date loan performance has been fair and there have been a minimal number of credits in which they have had to restructure the loan.

He admitted that because of the foreign exchange risk in their operation that they tend to lend to established companies and are risk averse to new start-up ventures.

We discussed the proposed cross-border investment fund and, like the Swazi situation, INDEBANK has several potential projects which would be immediately benefited by such a fund. They have a project in which again a Zimbabwe firm which would be providing technical assistance is precluded from making a shareholder investment due to foreign exchange restrictions of Zimbabwe. The problem is further complicated by an import permit problem and what appears to be a Malawian reluctance to allow further foreign investment from Zimbabwe. He felt that Malawi must sort out its own problems internally before it brings in Zimbabwean investors.

We discussed at length the pros and cons of the cross-border investment fund and some of the pitfalls that may exist if it was not tightly controlled. He agreed that any company that was to benefit from a cross-border investment fund would have to be an exporter and have the ability to remit a portion of his foreign exchange earnings back to the fund.

In further discussions he felt the export prefinancing revolving fund was a much more practical operation at this time and that their operation, INDEBANK, could in fact manage such a fund on a local basis. He did state, however, that their emphasis would be on the non-traditional corporations and that the use of such a fund to enhance agricultural production would best be left to someone with greater expertise in that area.

Finally, we discussed some of the basic transportation and cost problems associated with Malawian exports and Mr. Bishop reiterated a number of the problems cited by other businessmen in the country. He criticized the increased cost of transportation, partially due to sabotage, as being one of the greatest problems for Malawi in terms of efficiency for shipment as well as costs to market and produce.

CROSS-BORDER INVESTMENT FUND

There has been considerable discussion within the SADCC organiztion to develop mechanisms that would enhance intra-SADCC trade and investment. It is believed that such trade can only be expanded if SADCC countries are producing goods and services which other member countries require and that trade flows would necessarily increase as a result of increased intra-regional investment. An expanded productive base is a necessary prerequisite for expanded trade and increased investment is likewise a necessary prerequisite for expanded production. The concept of a Cross-Border Investment Fund has been developed to help facilitate this increased investment, production and trade.

The basic purpose of a Cross-Border Investment Fund (CBIF) is to facilitate cross-border investment within the SADCC region by providing access to foreign exchange for perspective investors and thereby allow a project to be capitalized as well as have the necessary convertible currency to purchase necessary inputs for production (raw material and capital equipment) which in most cases must be imported as well.

It is important to note that despite all the various benefits of the fund as described below and the potential for increased development that any new business venture offers, that the CBIF is actually a method to work around a basic economic problem within the region - the lack of adequate foreign exchange reserves. The CBIF does not solve this fundamental macro-economic problem but could bridge this situation temporarily and "prime the pump" for new investment and trade growth.

The current investment climates in the various countries within the SADCC region cover a wide gambit, from total private sector disincentive to open and fairly attractive policies. For historical reasons as well current economic instructions, southern Africa is not as attractive area for new foreign investment particularly when compared to other alternatives in the Far East. There is also a rather well pronounced political mood within the region that displays deep suspicions against foreign investors. There is understandable resentment against foreign shareholders who repatriate their investments quickly through dividend payments, royalties and technical fees. The problem is compounded by the foreign exchange shortages and the dominance of foreign-owned companies. In Zimbabwe more than 70% of the manufacturing sector is controlled by non-residents.

The CBIF would appear to adequately address these problems and provide a number of benefits to regional development, including:

a) Utilization of many technologies already developed within the SADCC region which are more appropriate than some imported systems.

b) The SADCC region can provide technical and managerial skills, manpower, selected raw materials and access to domestic finance.

c) The private sector in developing countries should expand and new employment opportunities will be created.

d) A shift from the historical dependency on foreign loans to local equity investment will result along with the possible substitution of local and regional ownership for the current high level of South African control.

e) Corporate earnings and dividend payments, even if repaid to the original investors country, would stay within the region. The beneficial multiplier effects of expanding business should develop.

f) Intra-SADCC trade should develop through usage of vertical integration among the different countries and companies. Both technological services and certain raw materials could be transferred directly from the investors country instead of being imported totally from abroad. Theoretically, there should be a corresponding foreign exchange savings if these transfers are allowed to be made directly. Common equity in a new company should enhance 'inter-company' trade as well as create a new product which would be available for export beyond SADCC.

There are also a number of structural constraints and impediments to the establishment of a CBIF which will have to be addressed before any fund can be created:

(a) Most SADCC countries appear to be reluctant to allow local capital to be converted into foreign exchange (even if this transaction is funded outside of Central Bank reserves) only to be subsequently invested in another country. This is considered a loss of capital in which the 'exporting' country receives no immediate benefit. This may be a short-sighted attitude but it exists nonetheless.

(b) The majority of the companies that have sufficient local currency liquidity and industrial strength to make a new investment appear to be the large multi-national corporations operating in Zimbabwe. There are reports that there are also smaller locally controlled companies interested in cross-border investment but this will have to be investigated further.

(c) It is obvious at the stage of research that the usage of the CBIF will be dominated by Zimbabwe businesses which are looking for creative alternatives to free-up frozen local currency. The fund could easily be mis-used as a vehicle for skirting existing government restrictions limiting the payment of dividends abroad. Consequently, an in-depth study of the actual market demand for such a fund, particularly among other countries in SADCC is needed. Is there enough market demand from other sources to help overcome Zimbabwean dominance?

d) A very basic question must be asked of each potential investing company as regards the benefit of a cross-border investment instead of investing local currency liquidity in local projects, thereby diversifying local economies as well.

e) The creation of a cross-border fund is in reality assuming the role of an intra-regional development bank and depending on the actual structure of the fund, a number of complicated organizational and management issues arise. In a normal economic system of free trade and adequate foreign exchange avaibility, the role of the CBIF would actually be performed by the established commercial bank and central bank systems.

f) Somewhere in the CBIF structure an approval process for each application for foreign exchange as well as a project analysis for each new investment must be established. These approval mechanisms will require staffing by a number of skilled technicians who are not necessarily readily available.

g) Currently, there are a number of very restructive government policies which must be addressed. Exchange control authorities, Central Banks and Ministries of Trade will all have to achieve some level of policy reform in order for a CBIF to function. There is a basic educational task to be undertaken to demonstrate the benefits of a CBIF to these policy makers. It is possible that the CBIF structure could require such basic policy reform before implementation.

h) The creation of a CBIF carries with it a considerable foreign exchange risk component due to the realities of future devaluations during the protracted time lag between the initial purchase of local currency by the fund and the delayed repayments from projected dividends - presumably earned in foreign exchange. A decision as to which party (the CBIF or the investor) would assume this risk is basic and could severely impact on the financial viability of any new projects.

i) A study must be done on each proposed project that takes into consideration the actual equity requirements of a new cross-border project which theoretically should not require a foreign exchange transaction, versus the required import needs (capital equipment, raw materials etc.). Many projects could actually utilize the proposed mechanisms of the Export Pre-financing Revolving Fund only and the equity investment requirements could be self-funded.

j) The concept of the CBIF includes its availability and administration on a regional basis. A number of issues were discussed at the recent round table in Harare which brought to light the difficulty of operating on a regional level at this time. Further study must be done to construct the optimal structure of a CBIF which satisfies regional needs and yet is able to contract with each country's authorities and operate efficiently at a bilateral level.

k) The CBIF was originally envisioned as a revolving fund which would be replenished with foreign currency as dividend payments are made to the original investor who purchased foreign exchange from the fund. This structure places a number of criterion on the fund which may not be realistic and the alternative of a non-revolving CBIF which further utilizes the purchased local currency must also be considered.

CBIF - Proposed Structure

As a result of a two-day round table discussion of the current government policies and economic situations as well as anticipated trade promotion activities for intra-SADCC trade development; the following structural guidelines were proposed for the establishment of a CBIF:

a) It was generally agreed that although the proposed Export Pre-Financing Revolving Fund offered more immediate impact to economic growth within the region, that the CBIF held promise for future benefits that, assuming some of the above described structural problems could be overcome, warranted further study and effort to establish.

b) It was further agreed that the CBIF Fund should be structured to include several pre-requisite features:

   a) Availability limited to locally controlled (greater than 50% ownership) companies. Large multi-national corporations would be considered to have alternative investment methods available to them if they truly wished to take on a new investment risk.

b) Priority would be given to investment in projects which promoted new economic growth for the SADCC country in which the investment was to be made, with emphasis on projects which would be net foreign exchange earnrts. Funds would be available for new ventures as well as the expansion or rehabilitation of existing companies. While export earnings were stressed, investment which further developed domestic economies and acted as de-facto import substitution projects would not be automatically excluded. In all cases, a local joint venture partner would be required.

c) The CBIF would be an agent for private sector development and government participation will be discouraged. At the same time the existence of different government structures within the region was recognized as a reality and a joint venture with an existing parastatal enterprise could be an acceptable alternative, to be approved on a project-by-project basis.

d) The initial funding of the CBIF would be relatively small in comparison to perceived demand. A suggested size for an initial fund was U.S.$10 million with a maximum limit for each project of U.S.$2 million. The belief was that it will be necessary to structure and implement several successful projects as positive examples before larger projects are undertaken and these positive examples will help influence future policy revisions.

The proposed CBIF is recommended to be organized along the lines of the model presented in Appendix 1, which call for a non-revolving fund with a small regional administration and actual operations at a national level.

Organizational and Operational Structure

It is recommended that the CBIF be established on a non-revolving basis. The main rationale for this is the extraordinary organizational structures that would have to be established to 'balance the book' of the fund if it were revolving. The amount of foreign exchange paid out at the time of the local currency purchase for investment will be much greater than any repayments (on re-purchases) through future dividend flows. Depending on the project, dividends may not be payable for a number of years as the new company must become profitable. Additionally, dividend earnings in foreign exchange are subject to too many variables (does the company actually earn foreign exchange? Will the government allow it to be remitted in convertible currency?). The time lag in any repayment schedule would also subject the fund to considerable foreign exchange loss risk in the case of future devaluations in either country.

A second level of constraints would be placed on the fund if it is expected to be revolving and therefore viable in the long run. A mentality could develop that dictates future decisions based on their impact upon the funds sustainability, profitability for coverage of administrative overheads and long term performance as opposed to the actual underlying purpose of the funds operation which is to promote SADCC trade and development.

Under the recommended structure the CBIF would be funded through a non-repayable grant which allows the fund greater flexibility to:

a) Negotiate actual operational agreements with each country's Central Bank and/or Ministry of Trade since no covenants, guarantees covering re-payment structures need be included.

b) Allows the CBIF administration to re-dedicate the local currency purchased to specific trade related projects (transportation improvement, support for local chambers of commerce, trade fairs etc.) in coordination with the USAID mission in each SADCC country.

c) Relieves the CBIF from establishing and organizational structure that is designed to perpatrate its own existence and long-term profitability. Administration at the regional level could be streamlined and actual overheads would be a minimal percentage of fund usage. Partial coverage of overhead expenses could be obtained by changing a commission at the time of foreign exchange purchases. A $1^1/_2$% flat fee is recommended which would theoretically earn US$150,000.

d) The ability to effect policy reform and establish participants criteria for fund utilization would be enhanced by the basic fact that better leverage exists through the creation a grant-funded, non revolving and non-tied CBIF. Repayment to the fund places negative covenants upon the participating governments and would effectively add to existing debt service burdens.

The CBIF under this structure is actually synonomous to a regional Commodity Import Program designed to target a specific market segment - private sector investors who are trade orientated. The CBIF cnd, in fact be titled in a variety of ways in order to allow it to be considered a regional USAID program despite the basic need to establish a series of national or bilateral operational agreements.

It is recommended that the initial funding for a regional CBIF program be limited to US$10 million despite a perceived demand for potential investment projects far in excess of this amount. It is more important to have this fund available to facilitate a few well chosen projects on a pilot basis than to obligate the total amount possibly necessary (in excess of $200 million) to meet all perceived demand. If further study reveals that the market demand for a CBIF actually exists on a region-wide basis then the subsequent funding of a CBIF could best be met with a multi-donor approach.

If actual project approvals are limited to a maximum of US$2 million, then the fund could facilitate 5 new investment projects and more likely a greater number as the average project needs is probably in the $500,000 range. Also US$10 million, converted to a group of local currencies represents a significant amount of new funds to pay for trade-related local projects.

Management of the CBIF will be critical and consequently the utilization of established institutions in the process whenever possible is strongly recommended. The CBIF administration should be limited to the regional level with authority to negotiate with each country's Central Bank, Ministry of Trade and National level operating entity for an effective investment agreement necessary for project implementation. The national level operating entities utilized could be established commercial banks, merchant banks or national development corporations. Whenever possible the use of local management expertise should be encouraged. These organizations have existing staff with technical and financial abilities to properly analyze, approve and control individual projects.

USAID should budget at least one and possibly two full-time employees to provide technical assistance for the entire project of trade promotion to the SADCC Secretariat. These persons would work with regional authority and be charged with responsibilities to include technical assistance in the areas of financial structure of projects, trade development and operations and economic research and analysis.

USAID ACTION - Short-term

It is recommended that USAID through it SARP office in Harare initiate and coordinate the following actions over the next 3 months:

a) Initiate an in-depth market and feasibility study for the CBIF. It is important that this study include a strong emphasis on market demand to determine the depth of the actual market for a CBIF within SADCC. So far all initiation for such a program has come from Zimbabwean business and a merchant bank which has an obvious self-interest in the project.

This study should be a team effort, ideally in coordination with the SADCC Trade and Industry group from Dar es Salaam and participation from one of the other potential donor agencies. The study team should include persons experienced in trade, investment finance and macro-economic policies. This study would therefore, require the hiring of at least two technical assistance consultants for at least a one month to six week period. Total cost is estimated to be US$50,000 - (including daily burdened rate, travel and transportation etc.).

b) It is suggested that USAID/SARP attempt to utilize the services of Mr. James Finucane who is a candiate for a full time position in this field. This study would be an excellent opportunity to work with Mr. Finucane and evalute his performance and long-term acceptability to this office and this project.

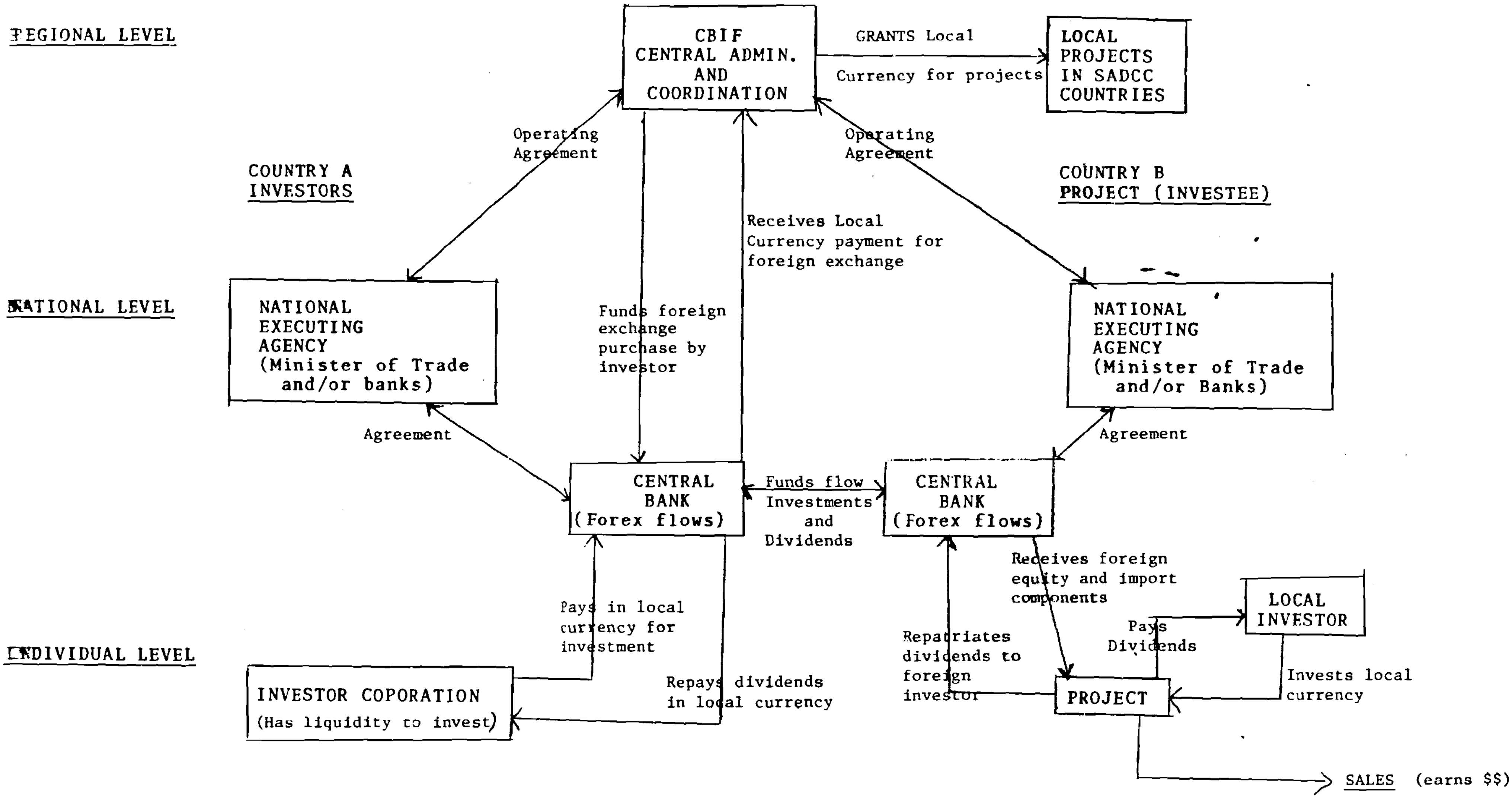
c) USAID/SARP senior officials should begin a dialogue with senior officials in the Zimbabwean government to discuss the concepts of the CBIF and determine the mood and receptivity of key officials.

d) Likwise a formal presentation of the findings of the round table discussion should be given to the SADCC Secretariat to insure future coordination and cooperation with these trade promotion activities. USAID/SARP should have a pro-active role in the survey studies to be conducted by SADCC even though they are grant funded.

e) USAID/SARP personnel should begin to discuss local trade opportunities with the various USAID missions operating within SADCC. The ultimate utilization of the 'basket' of local currencies held by the CBIF should be a coordinated effort which provides maximum positive impact for each mission.

CROSS-BORDER INVESTMENT FUND (CBIF)
(Non-Revolving)

APPENDIX 1



TRADE PROMOTION

Problem to be addressed

There is a dearth of intra-SADCC trade information which serves to limit the potential intra-SADCC trade. What information does exist is usually traded ad hoc between private sector producers or contained in government ministries. The latter type of trade information is old and of little value to potential investors and procedures.

Background

At the regional investment promotion meeting for SADCC countries held in Harare, Zimbabwe in November, 1986, the need for developing regional coordination and linkages was highlighted. This has been followed by the informal development of "business councils" in each SADCC member country. A major objective of SADCC to support these councils is to develop over the next five years the intra-regional linkages between the councils by developing an information exchange system which will monitor and share trade information on a continual basis.

In its incipient stages in this area, SADCC has received some donor assistance at the Secretariat level. The extent of this assistance is not clear, yet it appears to be of some importance.

The SADCC Industry and Trade Coordination Division of Tanzania has the lead role for SADCC and is in the process of compiling the following information:

- export/import directories or lists of export/import products;
- copies of existing bilateral trade agreements among SADCC member states; and
- collection of relevant studies on trade already undertaken in the SADCC region.

However, the passive role of information gathering should by augmented with a proactive program to provide up-to-date trade information on a formalized sharing basis. This will facilitate intra-regional trade and development.

Proposed Solution

The SADCC Industry and Trade Coordination Division has been established within SADCCC to undertake three primary roles, one of which is trade development. This small division is headed by a Director augmented by a small staff.

It is proposed that the division include a "Trade Secretary" who will interface with national governments and private sector as well as the SADCC Industry and Trader Ministers Committee. This person will be funded by SADCC and be of rank sufficient to ensure ongoing interfacing at the ministerial level.

The Trade Secretary will be augmented by donor funded assistance at the regional and national level. Regionally, short-term assistance as well as a possible long-term advisor will be provided to the SADCC Industry and Trade Coordination Division to work under the supervision of the Trade Secretary. This staff will be responsible, inter alia, for developing accurate trade information, current import/export trends and potential, developing computer linked systems with SADCC member business councils, etc. Donor funding for the design of systems and the provision of equipment to operate the systems is envisaged.

Nationally, SADCC member sponsored business councils will receive operating expenses assistance in establishing effective councils. This will include staff support, systems development and related assistance to develop a permanent council. The actual assistance needs are yet to be identified. However, it is not planned that donor financed assistance will extend beyond initial start-up and operations. The exception may be the provision of short-term technical assistance.

Combined, the regional and national level support will lead to a fully functioning trade and information sharing network. Such a network is an integral need to support donor funded trade and investment programs such as the IBRD export finance program in Zimbabwe and the Tanzania Seed Capital Revolving Scheme.

Program Design

To develop the trade and information network, short-term assistance will be required. At the SADCC Secretariat level, an assessment of staffing (long and short-term), administrative and operational procedures and systems is needed. At the national level, a generic package of possible donor support to relate with the SADCC Secretariat and the local community will need to be developed. Four to five national need assessments should be undertaken. This should be along the lines of the regional assessment.

To carry out the work required, a three person team is recommended. A systems analyst (2-3 weeks) should work at the SADCC Secretariat with possible visits to 1-2 countries. An institutional/administrative development specialist with experience in developing similiar operations will be needed (4 to 6 weeks) to carry out the regional and national assessments. A project design specialist (2 to 3 weeks) is needed to develop a consolidated program taking into consideration technical institutional and political considerations.

EXPORT CREDIT FACILITY

Problem To Be Addressed: The perceived problem is that some SADCC countries are "forced" to purchase imports from outside the SADCC region due to the availability of "more favorable credit terms" provided by other countries.

Proposed Solution: Create an Export Credit Facility (ECF) which would allow SADCC exporters to provide comparable credit terms to SADCC importers. Since normal commercial channels have not been utilized (where legally allowed) to provide such credit, such a facility would imply the provision of a subsidy to the importing country (or firm) by the ECF through the exporting country.

Rationale: Two basic reasons are given for the necessity of the ECF. First, central banks or other authorities of the SADCC countries require exporters to receive (and surrender) the foreign exchange payment for the exported goods within a fixed time period which is "too short" for the provision of the necessary extended payment period. Second, with the extention of credit to the importer, the exporting firm delays its receipt of the local currency equivalent of the foreign exchange due for the exported goods. These delayed receipts imply that the exporter must either maintain larger local currency working balances, or must take out a local currency loan for working capital requirements. In either case, the exporting firm incurs a cost based on the extension of credit and through prevailing interest rates in its country. If a competing credit line is at a lower interest rate (not necessarily a subsidized rate) than available from the exporter's country, the exporter would either incur a loss, or require a subsidy to meet the competitor's terms.

In essence the ECF would make the payment of foreign exchange to the exporter's central bank, thereby assuming the responsibility and risk for collecting the foreign exchange from the importer or importer's central bank. In addition, the fund could provide a longer period for the importer to pay, or provide the funds at a lower interest rate in order to effectively match the terms of the competing credit line.

Economic Viability: For the ECF to remain economicly viable and still satisfy its purpose, the interest rate charged would have to be high enough to cover its operating expenses and cover the amount of potential defaults by importers. Additionally, it must have an interest rate low enough to be competitive with any alternate credit lines offered. For example, if annual operating costs are two percent of the ECF's capitalization and annual defaults to the fund are limited to one percent of the ECF's capitalization, the ECF could provide credit at an annual interest rate of three percent per annum and maintain the nominal value of its capitalization (unless actual defaults exceeded the expected one percent of the ECF's capitalized value). If the real value of the ECF is to be maintained, i.e., maintaining the volume of exports (imports) financed, then the interest rate charged by the fund would have to be increased by the weighted average of the dollar prices of goods being financed through the ECF. Thus if this inflation rate were four percent, the ECF would require an interest rate of seven percent to maintain its real value and break-even on its operations.

If the rates calculated by the above methods are not competitive with any alternative credit lines, two options would be available to the ECF to meet the terms of the alternative credit lines. First the ECF could extend its credit for a longer period of time than provided by any competing credit lines. Following this option could provide enough of an incentive for the importer to accept the higher interest rate; however, by extending the payment period, the volume of trade which could be financed by the ECF would be reduced since the amount of ECF funds available would be reduced. The second option would be to operate the ECF at a real (if not nominal) loss which would involve a decapitalization of the ECF and require a future recapitalization of the fund.

The first option could be severely limited if the ECF is set up with a specified limit on the length of time for which credit can be extended. For example, suppose a Zambian exporter is looking at the purchase of an item, say tuna. The tuna can be purchased for the same price from Brazil who will provide one year terms at 5%, or from Mozambique who would finance the purchase through the ECF at a rate of 7%. To make the ECF terms comparable to the Brazilian terms without reducing the interest rate, the ECF credit would have to be extended for approximately a year and a half. If ECF credit is limited to any length of time less than a year and a half, the only way to make the ECF credit equal to the Brazilian credit would be to lower the interest rate and thereby decapitalize the fund.

Roundtable Discussion of the ECF: The roundtable discussion of the ECF raised a number of issues and/or comments. A brief summary the points raised is as follows:

1) The usefulness of an ECF would be highly dependent on the types of commodities being traded. For most items currently traded among SADCC members, an ECF would not be

particularly useful. Where an ECF would be useful would be in promoting intra-SADCC trade of capital-type goods. Given the current economic structure of the SADCC countries, Zimbabwe would probably be the major beneficiary exporting country if the ECF were limitted to capital-type goods.

2) There was a serious question of whether it would be appropriate for SADCC (or donors) to become involved with a scheme such as the ECF. First, the ECF is basically a banking activity which could be instituted by the member countries' private commercial, development or central banks without the establishment of the ECF. Secondly, the established PTA Trade and Development Bank would be the logical organization to provide such credit services on a regional basis since these services are normal for a trade bank. In addition, the PTA Trade and Development Bank, by its bylaws, is to devote 25% of its funds to trade promotion.

3) The fact that six of the SADCC members are also members of the PTA also raised problems. Under the terms of the PTA treaty, PTA members cannot offer preferential trading terms (such as those of an ECF) to other PTA members without extending those terms to all PTA members. Thus, the establishment of a SADCC ECF would necessitate the expansion of the ECF to the full PTA by the PTA member states in SADCC.

4) Yet another potential problem with respect to the PTA is that the use of an ECF would effectively block the use of the PTA clearing house. By its nature, the ECF must revolve to fulfill its purpose. This would involve the repayment of credit to the ECF in foreign exchange. The use of the PTA Clearing House would allow payments by the importing country in local currency. In this case, the ECF would be repaid in local currency rather than in foreign exchange since there is no guarantee that the ECF importing country would have a Clearing House deficit with the ECF exporting country. Such local currency payments to the ECF would quickly eliminate the revolving nature of the ECF, and thus eliminate the ECF's usefulness.

5) Another major question raised in the discussion concerned to what extent the credit-term problem really exists for intra-SADCC trade, and whether or not the problem may not simply be a problem of competitiveness and quality of SADCC producers' products, as well as the overvalued and artificially maintained exchange rates of most SADCC countries. A major study would be required to answer this question. (See the study description on page 53 of the Imani Development Ltd. Discussion Paper for an idea of what would be involved.)

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6) Determining a funding level for an ECF would require the same type of study as identified in item 5 above.

ECF Proposed Structure

A decision to proceed with the creation of the ECF would require a definite structure of agreements, reporting and financial transactions. These are described below.

1) Structure of Agreements

   A) Agreements between donors and SADCC which obligate funds for an ECF and establish any conditions and requirements (e.g., eligibility restrictions or requirements, reporting, and so forth).

   B) Agreements between SADCC and participating Central Banks (who would act as the implementing authorities) regarding the use of the funds and general procedures.

   C) Agreements between the participating Central Banks concerning the guarantee of payments. (Note: This agreement could possibly be subsumed in the SADCC-Central Bank Agreements of item B above.)

   D) Agreements between importers utilizing ECF credit and their central banks concerning the importer's intent to make the local currency deposits required at the end of the credit period. These agreements would be required for each transaction utilizing the ECF.

2) Structure of Reporting

   A) SADCC would be required to submit reports to donors concerning the use of donor provided funds and concerning the utilization and operation of the ECF.

   B) Reports from the exporting countries' central banks (the ECF Implementing Authorities) concerning the utilization and operation of the ECF in their countries.

3) Structure of Foreign Exchange Flows

   A) Upon signature of the SADCC-Donor Agreements, donor funds (forex) go to SADCC as the ECF Central Authority.

   B) Upon signature of an agreement or set of agreements between SADCC and the exporting countries' central banks, SADCC would release funds to ECF accounts in the central banks.

C) Upon completion of an ECF-financed transfer of goods, ECF-funds in the exporting country would be released to the exporting country's general forex account.

D) Upon payment by the importing country, forex would be redeposited in the ECF country account of the exporting country.

4) Structure of Local Currency Flows

A) At some point local currency may be deposited to donor accounts by SADCC or the ECF exporting countries.

B) Upon the transfer of ECF funds to an exporting country's general forex account, the exporting country's central bank would transfer local currency to the exporter or the exporter's commercial bank.

C) At the conclusion of the ECF credit period, the importer would deposit an appropriate amount of local currency with the importing country's central bank (possibly through a commercial bank) to trigger the release of forex to repay the exporting country's ECF fund.

5) Typical Transaction Process

Exporter:

1) Exporter and importer agree to a trade transaction provided credit terms can be arranged.

2) Exporter applies to the ECF implementing authority for permission to use the ECF; permission granted.

2a) Exporter applies for an export permit (if necessary; permit granted.

3) Exporter sends goods to importer.

4) Upon certification that the goods have been shipped (received), exporter's central bank transfers funds from ECF fund to general foreign exchange account and transfers appropriate amount of local currency to exporter's account.

5) Once foreign exchange has been transferred from the importing country at the end of the credit period, the exporting country's central bank deposits the foreign exchange in the ECF fund.

Importer:

1) Exporter and importer agree to a trade transaction provided credit terms can be arranged.

2) Importer applies to central bank for permission to utilize the ECF; permission granted and agreement signed.

2a) Importer applies for an import license (if necessary); license granted.

3) Importer receives goods from exporter.

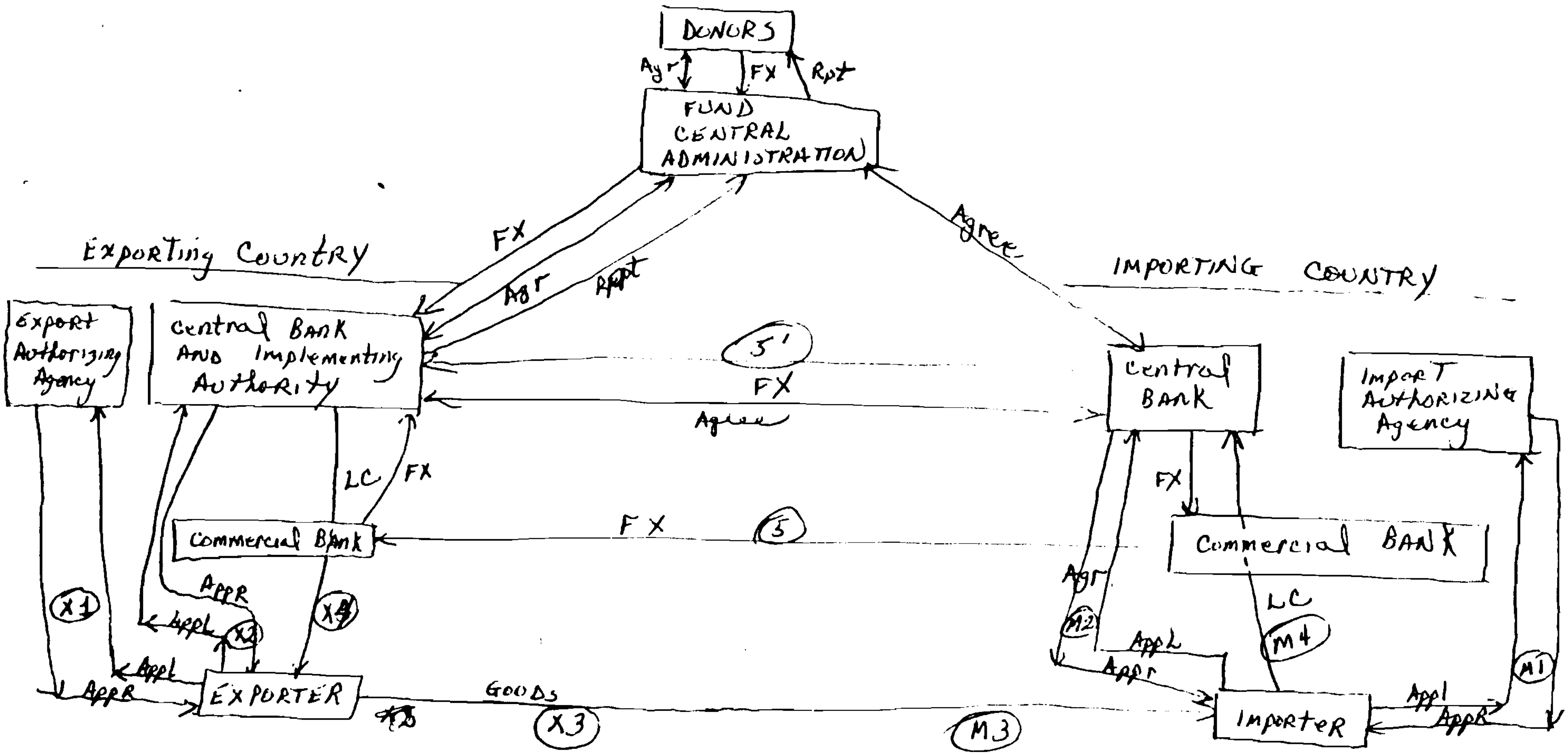
4) At end of the credit period, importer deposits local currency with its central bank.

5) Importer's central bank transfers foreign exchange to exporter's central bank for credit to the ECF. (This transfer may occur through commercial bank intermediaries.)

(document: /BROWN/RHECF. 29/07/87)
(drafter: RHarber, Program Economist, USAID/Zambia)

CHART

EXPORT CREDIT FACILITY



Key:

Agr = Agreement

Appl = Application

Appr = Approval

Rpt = Report

FX = Foreign Exchange

LC = Local currency

EXPORT PRE-FINANCING REVOLVING FUND (EPRF)

Problem to be addressed

Due in large measure to constraints on foreign exchange availability within many SADCC member countries, productive enterprises are being severely constrained from undertaking export orders because of the inability to import essential inputs. The lack of foreign exchange has resulted in a decline in productive sector investment and production as well as the imposition of governmental controls that prevent market development and inhibits overall economic growth.

Background

Generally speaking, within the SADCC countries, there is no shortage of liquidity. Consequently, there is not generally a need for additional working capital to support export or domestic oriented production. The main exception is in the area of small scale enterprises which perhaps by definition have a problem raising any kind of finance. For most of the companies who are potential exporters, working capital can usually be provided by existing financial institutions albeit at fairly high rates of interest. Most SADCC countries have an established commercial banking sector as well as several development orientated government-sponsored financial institutions such as development banks and funds.

The main need within the region is rather for the provision of foreign exchange. The three exceptions to this are Botswana, Lesotho and Swaziland. In all the other six countries, the manufacturing sector particularly, is functioning at low levels of capacity utilization due to the inability to import essential inputs. The motivation for a fund is that if exports are undertaken, foreign exchange will be earned for the country. To increase productivity, foreign exchange must be made available to import the necessary inputs in the knowledge that such foreign exchange will be replenished out of the export proceeds.

EPRF

The concept of a SADCC Export Pre-Financing Revolving Fund (EPRF) has been discussed within SADCC circles at considerable length over the past two years. Currently, with USAID funding, SADCC is endeavoring to undertake a feasibility study for establishing such a fund. This study, expected to be concluded early FY 1988, will provide the regional analytical and national framework for the fund.

Two separate models have been developed for consideration. These are based on the various written reports (e.g., Imani and SADCC studies), the USAID sponsored roundtable and a mixture of developmental and business perspectives. These are a fund which revolves with foreign exchange earnings and a once over fund with local currency generations. These are depicted in Charts 1 and 2, respectively, and explained more fully below.

However, certain common elements are presented and assumed for each model. These are as follows:

a) Grant Financing: Given the development objectives, current economic status of the countries and the complexities arising from debt service which would result from region-wide national repayments, use of grant funds is recommended.

b) Central Fund Administration: A centralized entity (most likely the grantee) will coordinate design and implementation of national level funds. It will also monitor usage of the national funds and intercede, as may be appropriate, to ensure adequate implementation.

c) Foreign Exchange Risk: The foreign exchange risk is to be assumed by the ultimate user of the funds bieng provided.

d) Country Risk: The fund assumes country risk to the extent that the Central Banks are unwilling or unable to assume such risk.

e) Export earnings: It is assumed that clients will be net foreign exchange earners. Although local currency earnings may occur vis a vis intra-SADCC trade, those are not planned for in the models as further detailed below.

f) Central Bank: It is assumed that accounts are maintained in the Central Bank as detailed below.

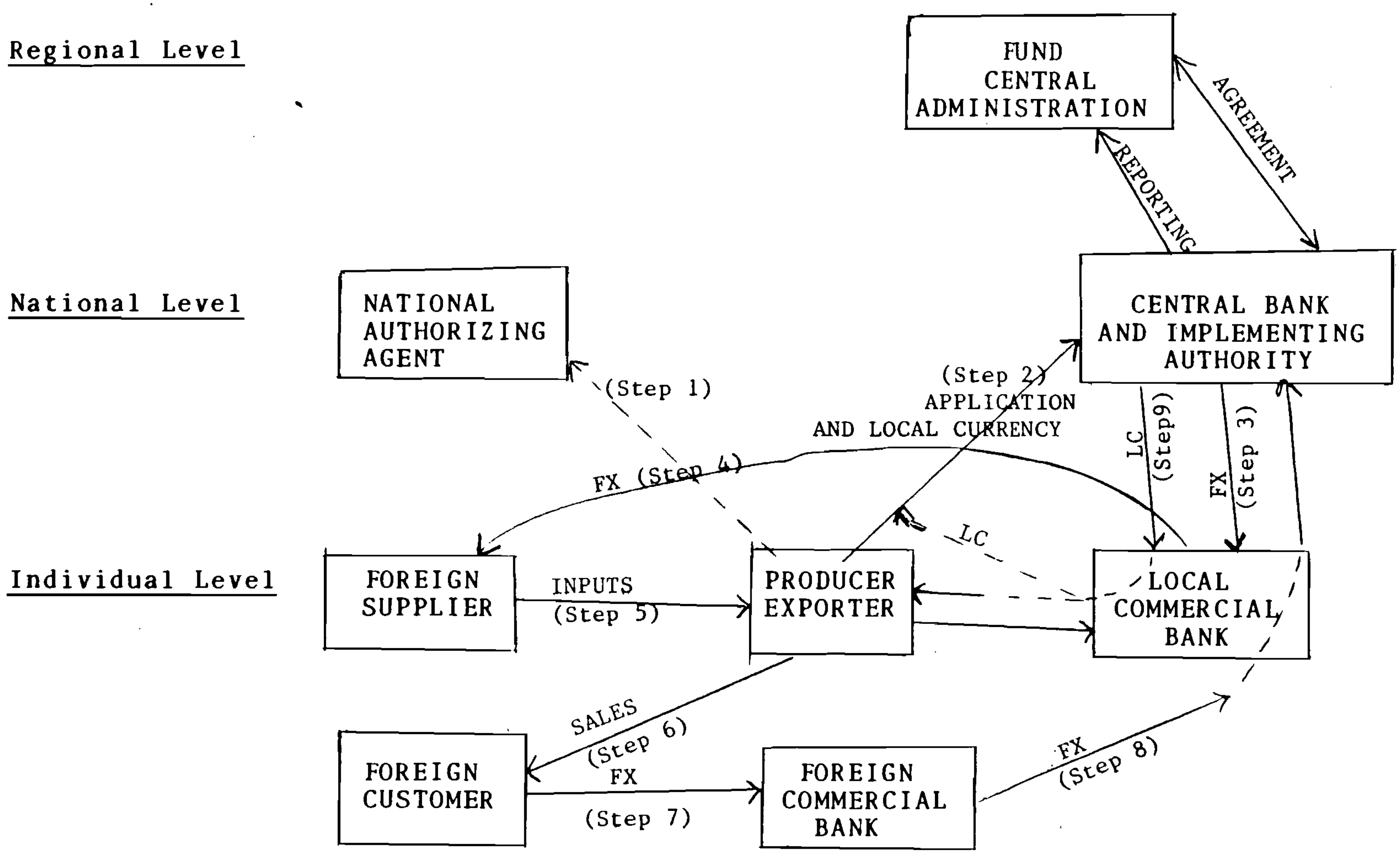
EPRF (Revolving Model)

This model, depicted in Chart I, is designed to finance foreign exchange inputs (raw materials, intermediate goods, capital goods, etc.,) for subsequent export earnings. The fund revolves with each completed transaction and is further capitalized over time based on the export earnings. Intra-SADCC trade assumes foreign exchange payments with no role accorded to the PTA Clearing House.

1. Fund Central Administration. Initially, the fund central administration is the original receiver of the grand funds. Jointly with USAID/SARP and based on demand analyses and intended usage (allowable producers), the funds are earmarked for national usage. An agreement is reached with the Central Bank and implementing authority to reprogram elsewhere within SADCC should the funds not be utilized as planned.

CHART I

EPRF REVOLVING MODEL



2. Central Bank and Implementing Authority. In the model, these are one and the same (IBRD Zimbabwe Program). In some countries, the implementing authority may be a national development bank or similiar body. In this case, the Central Bank maintains the relevant accounts and overall banking function. In the model, the unit reviews, approves and extends the foreign exchange pursuant to agreed upon criteria. It also receives foreign exchange payments. The Unit maintains day-to-day implementing and monitoring responsibilities as well as coordinates reporting to the fund central administration.

3. National Authorizing Agent. As applicable, this denotes export permits, import permits (intra-SADCC trade), etc.

4. Producer Exporter. This is the company who requires the foreign exchange input.

5. Foreign Supplier. This is the off-shore company that provides the foreign exchange inputs.

6. Local Commercial Bank. This is the producer/exporter's bank. It supplies the local currency, arranges payment to the foreign supplier and receives foreign commercial bank payment.

7. Foreign Customers. This is the buyer of product(s) made by

the producer/exporter.

8. Foreign Commerical Bank. Upon receipt of goods, this bank makes payment pursuant to orders by the foreign customer.

Model Transations

The model consists of nine steps which are detailed in Chart I. Prior to explaining each step, it is important to note that at the national level the fund is established as a foreign exchange account within the Central Bank. As demonstrated below, this fund grows through time and reflows can be programmed, as may be desired, to allow for other than straight foreign exchange export earnings.

Step 1. The local producer/exporter applies for an export license.

Step 2. With export approval, the producer/exporter applies to the EPRF with the appropriate application and local currency required. This may be done through his bank. The EPRF will charge a facility fee, i.e., 1% of Fx value, to be paid in local currency, or, as is more desirable, in foreign exchange during step eight.

Step 3. The Central Bank makes the foreign exchange available for use by the producer/exporter. Typically, a small fee in local currency would be charged.

<u>Step 4</u>. The producer/exporter's local commercial bank issues a letter of credit on behalf of the foreign supplier to be paid upon receipt of the inputs (step 5). This payment is typically made to a corresponding foreign bank.

<u>Step 5</u>. The foreign exchange inputs (i.e., raw materials, intermediate inputs, capital equipment, etc) are supplied to the producer/exporter.

<u>Step 6</u>. The producer/exporter completes the production cycle and arranges for export. Goods are sold to a foreign customer. The model assumes extra-regional sales or intra-SADCC sales with foreign exchange payment.

<u>Step 7</u>. The foreign customer issues foreign exchange payment instructions to his bank. During steps 7 and 8 it may be required that the foreign exchange due payable to the EPRF is identified and included as a set-aside payment.

<u>Step 8</u>. Payment is made from the foreign commercial bank to the credit of the producer/exporter. This may be to the producer/exporter's bank (steps 2, 3, 4) or to a corresponding bank locally. The funds due to the producer/exporter are converted to local currecy through

the Central Bank. The foreign exchange funds due to the EPRF's account in the Central Bank. The latter could include a percentage increase, i.e., 1-3%, as a cost of funds usage by the producer/exporter (step 3). This percentage increase is passed on to the foreign buyer (step 6) in cost of goods purchased. As long as the percentage increase to the producer/export is reasonable there is no reason not to assume that it can occur.

Step 9. Local currency payment due to the producer/exporter is made by the Central Bank. This concludes the model.

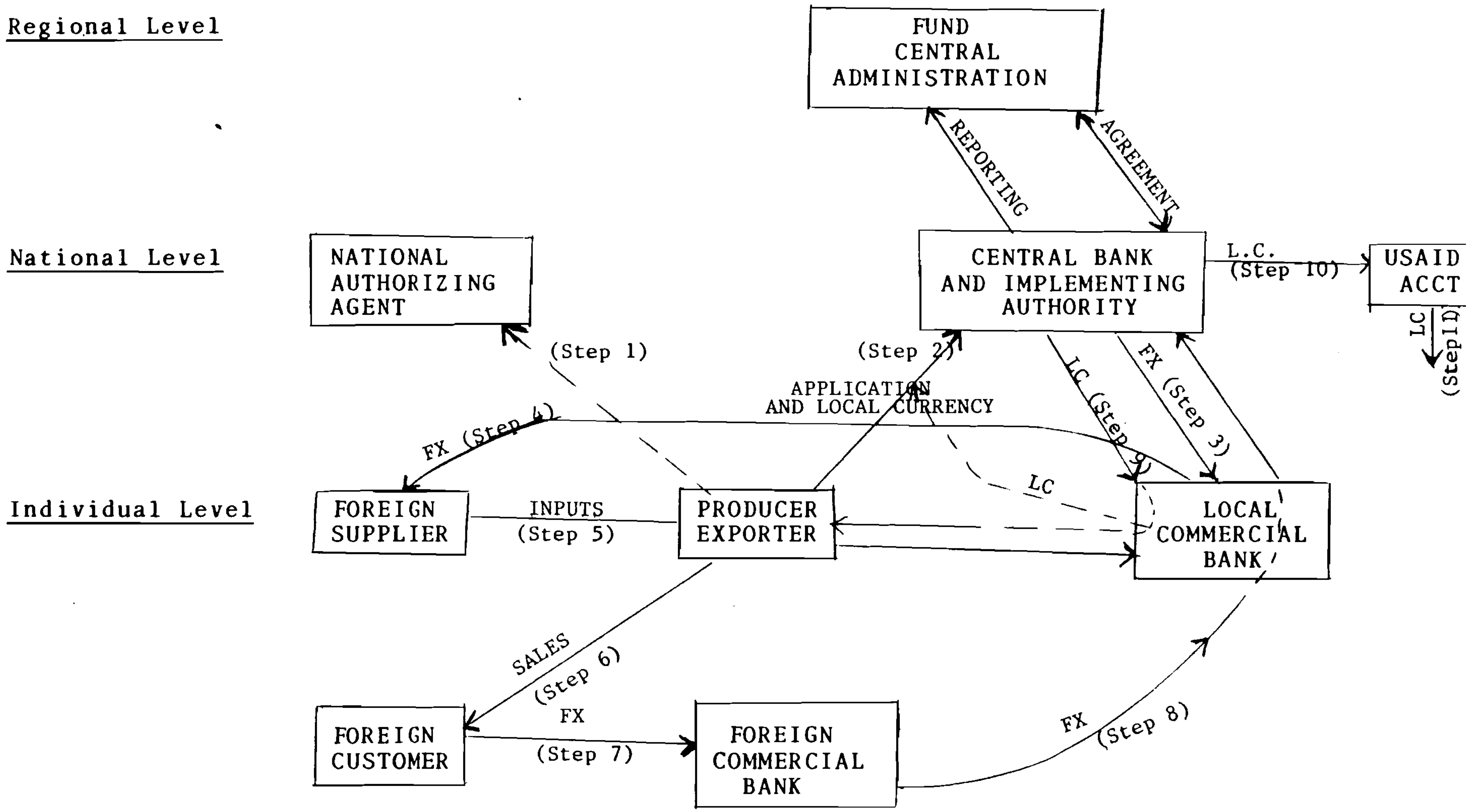
EPRF (Once Over Model)

Chart II depicts the non-revolving model. The model assumes that for whatever reason (policy, practial administration, degree of success of negotiations between fund central administration and the Central Bank, etc.) the foreign exchange being provided is a once over transaction. Steps 1-9 remain essentially the same.

For the provision of foreign exchange, the Central Bank commits itself to make available to USAID the local currency equivalent (step 10). This can be a one time generation, i.e., at the beginning of the model, or capitalized as the foreign exchange is used (purchased) by the producer/exporter. In step 11, the local currency generations are used to address key constraints to

CHART II

EPRF ONCE OVER MODEL



productive sector growth. Examples would include the transport sector and additional local currency lending.

The Roundtable Discussion and General Observations

During the July 27 and 28 Roundtable discussions, the EPRF received wide support for its potential impact within the SADCC region. It was agreed that the constraints as well as potential usage (countries and sectors) identified in the Imani report were essentially correct. Several other specific observations were made. Their overall validity should be considered and they are presented here for informational purposes.

1. Fund Central Administration. There is no need to create a new regional institution to administer the fund. Administration of the fund can be as lean or as detailed as desired.

2. Size of the Fund. Additional analyses are needed to determine both effective demand (regionally and nationally) as well as which sectors should be included. Many participants thought the fund should start small, identify degree of success and then determine future funding levels.

3. Zimbabwe and Tanzania Funds. Both countries operate funds similar to the proposed EPRF (see Imani Report). During design work for the EPRF these should be examined to ascertain

valuable features and/or implementation problems which may be applicable to the EPRF.

4. Eligibility Criteria. In addition to 2 above, consideration should be given to participating criteria. These include, *inter alia*, (a) export earnings, (b) degree of local ownership, (c) issue of parastatal participation, (d) productive sector (agriculture, industry, etc.), (e) mixture of traditional vs non-traditional exports, etc.

5. Foreign Exchange. The EPRF model is based on net foreign exchange earnings. In Zimbabwe, the IBRD program served over time to stifle domestic production. Will this occur here? Also, the issue of how you handle intra-SADCC trade needs to be considered.

6. Local Currency. The EPRF model assumes liquidity and that the producer/exporter will have access to local currency.

7. Fund Flexibility. This needs to be considered from the start. If you limit the fund participation to those producer/exporters who have an existing export order, this will serve to limit participation. (Note: I think an export order is needed, otherwise a risk is assumed on the transaction).

General Observations

It is apparent that the private productive sector needs to be stimulated to continue economic and social growth. The problems associated with declining export earnings in primary products, over valued exchange rates, governmental controls, etc., have been well documented. Of the funds considered, a revolving pre-export finance line can make a significant medium-term impact on stimulating export earnings and overall private sector growth. Moreover, such a fund fits well with AID's mandate and, equally important, is a workable concept as demonstrated elsewhere within AID.

There are, however, important issues and problem areas to be considered. This fund will require working with separate national government institutions such as the Central Bank, Ministries of Trade, Commerce and Industry as well as a diverse private productive sector. The fund can be structured as a regional fund, yet in reality will work as a national program. In further developing the fund, other observations become apparent.

1. Design Work. To further develop the fund, several important areas need to be considered, including the following:

   -- a demand analysis is needed to ascertain overall size of the fund;
   -- an assessment of the private productive sector will be

needed to ascertain types of inputs needed, intended usage, prioritizing eligible participation, anticipated impacts, etc.;

-- consideration will need to be given to national policy implications on the fund as well as the opportunities to affect policy changes due to the fund;

-- fund administration will require an examination. It is suggested that the fund cover, fully or partially, the central fund administration while national Central Banks absorbing local costs;

-- the role of USAID monitoring will require staffing considerations. A project manager serving as a regional circuit rider is envisaged. This person could be placed within the grantee or within USAID/SARP;

-- the length of terms to fund users will require consideration. The longer the planned usage, the less rollover and multiplied impact will occur; and

-- other donor participation and the role of other donor programs will need to be examined. This should include the ongoing IBRD Zimbabwe and the Tanzania programs as well as new initiations.

Technical Assistance

The design of the fund will require analyses such as the ones identified above. A mixture of talent will be required. It is recommended that a firm be selected to ensure that the end product is acceptable to USAID/SARP. Team members should include (1) a trade/investment banker with Southern Africa experience (4 to 6 weeks) to examine product and producer issues, (b) an economist (4 weeks) to develop the relevant macro and micro-economic analyses and impacts, (c) an institutional analyst (4 weeks) to structure administration of the fund at the regional (grantee) and national levels and (d) a project design specialist (4 to 6 weeks) should USAID/SARP not have the in-house or AID/W TDY assistance.

Implementation of the fund will conceivably also require a mixture of long and short-term technical assistance. This would include an in-house long-term advisor located at the grantee working on overall regional implementation, monitoring and coordination. Extensive short-term technical assistance will most likely be needed to structure national level fund activities. The need for long and short-term technical assistance should be included in the analytical work identified in developing the fund.