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Barriers to Business Expansion in a New Environment: The Case of Senegal

Liberalization efforts undertaken to date by African countries, including Senegal, have dramatically changed their macroeconomic and private sector environments. However, many enterprises are still not able to take advantage of new opportunities. Many hypotheses have been advanced to explain this. First, it is possible that the liberalization efforts to date have only been partial. Second, it is possible that the private sector is responding, but its activities are not being accurately measured. Finally, private firms may not be adequately equipped to respond to the new challenges offered by liberalization and increasing economic integration.*

The real or imagined inertia of the private sector is the focus of much attention in the development world. This study was conceived within the framework of a public-private sector dialogue on this topic. USAID/Senegal seeks to assess the nature and breadth of the constraints affecting the business environment and hopes that the results of this study will permit the prioritization of future reform efforts.

The approach used and developed by AIRD is based on firm-level interviews. It consists of the classification and quantitative evaluation of constraints as identified by the enterprises themselves. In order to assure the cooperation of firms and the collection of reliable information, the firms were chosen on the basis of personal contacts and the intervention of professional organizations, with an eye to sample diversity across sectors. The sample consists of thirty-one firms of all sizes, representing nine sectors of economic activity and targeting industrial country, regional, and local markets. Our findings, while not statistically significant, are offered to stimulate a debate in Senegal about challenges facing

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the private sector today and to suggest axes of reflection for the future.

Recommendations

Several major constraints were identified during the course of the interviews, including electricity supply, capital availability, access to markets and competition from imports, input availability, private sector-government relations, labor code and market, transportation, and internal firm management. The ensuing recommendations, which will be debated at a private sector-government roundtable in Senegal in December, 1999, are summarized briefly below.

1. Improvement of physical infrastructure: Producers complain of unreliable and expensive supply of electricity, transport, and telecommunications services. Privatization of the parastatal organizations which presently control their supply and the introduction of regulatory agencies to monitor the creation of distributorships and the setting of rates will be required to lure foreign and domestic investors into these key sectors. In addition, if regional trade is to be encouraged, especially under the West African Economic and Monetary Union (WAEMU), rehabilitation of the Dakar-Bamako rail line will be important.

2. Improve the competitive market environment: Regulatory environments must be strengthened either before, or concurrent with, the privatization of parastatal organizations such as SONATEL or SENELEC or the liberalization of activities in which they have a monopoly position in the market, in order to establish fair and open competitive market conditions.

3. Financing: Encouragement of broader competition among banks and between bank and non-bank financial institutions, including venture capital firms, is essential. In order to accomplish this, barriers of entry must be eased. Such competition should improve bank-client relations and lower the financial service margins. A national banking charter is also necessary to clarify the rights and responsibilities of all firms in the sector. Deposit insurance and use of insurance assets as a source of lending capital would also mobilize and strengthen financial sector resources. The dissemination of information regarding alternative savings opportunities would allow insurance and social security institutions to negotiate a return higher than the 4% presently offered by commercial banks. This will become easier as new financial institutions are created. The requirement of a presidential decree approving financial sector actions should also be eliminated. Finally, the policy for establishing bank lending rates needs review in order to assure that financial institutions can profitably lend on behalf of higher risk investment opportunities.

A review of certain non traditional methods of financing (such as leasing) should be undertaken. Moreover, the fact that leases cannot be used to secure refinancing from money markets, which offer capital at lower rates of interest than short-term bank savings, restricts opportunities for leasing companies to reduce the costs of their operations.

4. Simplification of temporary duty regimes and tax system: Recognizing

that the Senegalese economy is already quite open to world markets, Senegalese firms supplying export products need to have facile and low-cost access to imported inputs. In order to make firms of all sizes competitive on world markets, it is recommended that trade tax systems be simplified, and their administration strengthened, to facilitate such a transition.

One approach would be to utilize an industry-specific coefficient to measure the value of trade taxes paid on imported inputs used in the manufacture of export goods and to reimburse the manufacturer immediately on the basis of these coefficients. Such a system could be accompanied by ex-poste controls, rather than detailed control at the moment of the request for reimbursements, as is the present case. Abuses would be sanctioned with heavy penalties, including the possibility of loss of privilege to the duty exoneration system. The approach presumes a comprehensive, computerized database on firm activities. As Senegal is still far from such a database, an intermediary solution would be to simplify the actual system by reimbursing firms up to 75% of the duties paid, with the remaining 25% reimbursement subject to a more careful analysis of actual costs.

It is also important to simplify the actual tax system and eliminate those which have a low yield. Firms face such an large array of taxes that the incentive to indulge in tax evasion is quite high.

5. Improvement in private sector-government relations: New legal and regulatory environments are required to clarify the respective rights and duties of firms and the public sector. Senegalese enterprises are concerned about taxes (costs and abuses), customs (duty rates and fraudulent enforcement), and the general decay in law and order within municipalities and in interaction with government officials which hamper many aspects of business operation. Continued training and adequate compensation of public officials should ensure higher motivation and quality of service.

6. Attention to internal firm management: Numerous consultations among the Senegalese government, private actors, and aid donors have led to the acknowledgment of the need to improve internal firm management systems. Institutions offering redundant services in this area have been consolidated under the rubric of the Conseil National de Développement du Secteur Privé, in order to eliminate duplication of efforts and to improve management practices of Senegalese firms. Services required include strengthening of professional associations as much as of the individual firms they represent, with respect to human resources, industry information services, and lobbying capacity training.

7. Research areas: In several areas, research is required before proceeding to specific recommendations. These include studies of:

- **Impact of tax incentives and other factors influencing trade and investment in Senegal in the context of WAEMU** to evaluate the impact of WAEMU's customs union and investment code harmonization on Senegalese enterprises and, in

particular, in key sectors, particularly considering the cost of factors of production (except for telecommunications) are significantly higher in Senegal than in the rest of the sub-region. This work could focus on certain value-chains: ocean fishing (management of fish stocks), textiles, new technologies, telecommunications-based services, and pharmaceutical products. Furthermore, the studies should consider locational advantages of each industry (advantages and disadvantages of Dakar and Senegal relative to other national and regional alternatives).

• **A study of the sources of weak labor productivity** should be undertaken to help understand the various factors (capital equipment, public services, seasonal labor market fluctuations, labor codes, management, worker qualifications) which may result in low productivity of the Senegalese workforce in both formal and informal enterprises.

• **Informal sector study** to understand the motivations of entrepreneurs in the informal sector in order to create appropriate institutions which can respond to their needs and help improve their productivity.

• **Subsector studies in areas where Senegal has potential for competitive production, especially in the context of WAEMU** would help to identify the specific factors and likely potential in a given industry which presently constrain expanded production and exports. For example, in the textile sector Senegal produces cotton fiber of excellent quality which is exported without any additional local value-added processing. This fiber could serve as the raw material for a series of locally produced intermediate or final products. The sector faces highly competitive export markets but local products have preferential access to them and Senegal could specialize in high quality, differentiated products. What are the necessary conditions for establishing industries whose final outputs are competitive on export markets?

• **A comparative study of anglophone/francophone African financial institutions** to understand the reasons behind the apparent improved competitiveness of the former, relative to the latter. Such work would reveal that anglophone African countries enjoy a much more diversified financial sector, both in terms of the number of existing banking and non banking institutions and financial sector products available, especially to small and medium sized enterprises. This study would examine the historical, political, economic, and cultural reasons for these differences.

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