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USAID/SENEGAL

PRIVATE SECTOR STRATEGY

March 10, 1988

The Goal

USAID/Senegal's private sector strategy seeks to better living standards through an active private sector. It is based on the premise that liberalization of the economy and a growing role for private enterprise will improve access to resources and make for more efficient resource management, and that the result will be increased production, incomes and employment and better health. To support private sector development, the Mission's program does three things: (1) assists the government's structural reform effort to remove constraints on private business and to shift services from the public to the private sector; (2) encourages the private sector to absorb increased responsibility for tasks previously done by government; and (3) explores ways to strengthen the private sector through credit delivery, management training and technology transfer.

The Problem

Senegal needs a strong private sector to achieve the economic growth required to create jobs and increase income. It also needs a strong private sector to increase the efficiency of services in areas such as health and agriculture that traditionally the government has sought to supply. Despite relatively good growth for the past two years, Senegal's growth rate since independence in 1960--an average of 2.3 percent per year--has been exceptionally low for an African country unafflicted by political disturbances. The lowest of French speaking countries in Africa, it has lagged well behind a three percent population growth rate and well below the pace required to absorb the 100,000 new workers entering the job market each year. Forty percent of the workforce is unemployed or under employed. Per capita income is half that of Cameroon and the Ivory Coast.

Most workers--more than two-thirds--are in agriculture, many in marginal jobs. But agricultural production--millet, sorghum, rice and cattle for domestic consumption, peanuts and cotton for cash and export--has been subject to the vagaries of government policies, climate and world markets. In a good year it produces two-thirds of the country's food needs and 19 percent of GDP.

A small industrial sector employs 10 percent of the workforce and provides 29 percent of GDP. Industrial growth has been stagnant; employment in industry has actually declined in the last few years. Services--trade, transport and tourism--employ 13 percent of the workforce and contribute 52 percent of GDP.

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Senegal's formal sector: Senegal's formal private sector is fragile and in transition. Although Senegal inherited a strong infrastructure and a relatively impressive private sector at the time of independence, independence also brought the fragmentation of the West African market. Companies serving a population of 27 million were forced to focus on a market of 3.5 million. Those that survived usually only did so with government protection, and where the private sector withdrew or failed to develop, the government felt obliged to intervene. As a result, Senegal's formal business sector is dominated by government, by public and parapublic companies. The government has majority participation in 86 companies and minority interest in some 100 others. It has majority interest in the largest groundnut oil processing enterprises and the two phosphate mining companies. It has interests in salt, cotton, fertilizer, ship building and repair.

Where the formal private sector exists it is dominated by a few large companies--usually French-owned. The Lebanese, who have long controlled small and medium-sized commercial enterprise, have substantially increased their holdings in larger commercial companies and moved into medium-scale manufacturing. Senegalese and Mauritanians have moved into petty commerce, and a few Senegalese have joined with French and Lebanese partners in areas such as fishing, which require 51 percent Senegalese ownership, or have gone into real estate and construction. Senegalese are also active in micro and small enterprise development and constitute, by and large, the informal private sector.

Private firms in the modern sector operate with a number of constraints. Profitability is cut by high production costs. Labor laws contribute to labor costs that are more than twice those of Benin, Togo or Mali, and labor productivity is only 25% of that in the Ivory Coast. Power costs are almost twice those of the Ivory Coast. New companies face a maze of tariffs and monopoly licensing arrangements that make breaking into an already limited market prohibitively difficult. And during the 1970's and early 1980's severe droughts sent agro-based industries into a recession and cut consumer demand for manufactured goods.

The fragility of Senegal's formal private sector is especially apparent in manufacturing. Some 300 companies employ 27,000 workers but a handful of companies are responsible for most of the employment and much of the production. Three companies, a French-owned sugar firm and the parapublic groundnut oil processing operations, employ nearly a third of all employees in manufacturing. A dozen state-owned firms account for 30 percent of manufacturing value-added.

Most plants operate under capacity; in recent years groundnut mills have operated at 30 percent of capacity, fish processing at 50 percent, textiles at 40-60 percent and some plants in mechanical industries at below 20 percent. Many companies, public as well as private, are deeply in debt; the average debt-equity ratio is 4:1.

But not all of the private sector is suffering. A limited number of companies have survived, even thrived, protected by high tariff barriers, monopoly licenses, customs exonerations, patronage, special access and influence. And the informal sector, uninhibited by the controls besetting the formal sector, operates freely, employing three times the workers in formal businesses.

Small and medium-sized enterprises: Small and medium-sized businesses appear to offer potential for considerable growth. A 1984 survey by Leopold Lawson carried out for USAID showed more than 900 small and medium-sized enterprises operating in Dakar, some employing as many as 200 workers, in metal, wood working, manufacturing, textiles, printing, construction and trade. Nearly 80 percent were Senegalese-owned. Capital costs per job created were well below those of larger firms. In the past two years, USAID's Community and Enterprise Development Project has identified in Kaolack and Fatick a robust small enterprise sector capable of borrowing at self-sustaining interest rates and realizing rates of return on investment often above 50 percent.

Policy reforms: The need to strengthen the formal private sector has become increasingly clear as the government has come to realize its own limitations. Beginning in 1983 the government launched a program of economic reform, imposing financial austerity and increasingly seeking to delegate responsibility to the private sector. The New Agricultural Policy included plans for liberalizing the supply of agricultural inputs and encouraging private trading of agricultural production; the 1986 Cereals Plan urged private sector participation in production, marketing, imports, storage and transportation. The New Industrial Policy called for disengagement of the state, privatization of public companies and increased incentives to private investors.

Three objectives of the structural reform are to boost the average annual rate of real GDP growth to 3.8 percent, to curb inflation, and to reduce the balance of payments deficit. To achieve these objectives will require expanded and diversified agricultural production both for domestic consumption and export; a key area of expansion should be in cereals production, as the result of liberalized marketing, increased irrigation and improved technologies. In industry, the effort is to remove government restrictions on private operators, increase competition, limit direct government supports and spur private decision-making and investment. The government has already reduced tariffs and quantitative restrictions on imports, eased some price controls, and has under consideration changes in regulations affecting labor.

The government has made good progress in its reform program. The impact, due to good weather as well, is reflected in the 4.2 percent growth in GDP during the past year (1987). The government remains committed to a continued strategy of promoting private initiative and increased efficiency through price and incentive policies, privatization of state-owned enterprises and services and a reduced government involvement in production.

The transition to a free-market economy will not be easy. Cutting back public involvement and removing protection in specific industry sectors, the restructuring necessary for sustained growth and increased jobs in the long term, will carry real immediate costs. A 1986 study by the Boston Consulting Group concluded that restructuring could eliminate 2,750-4,100 jobs in the short run and certain activities would be forced to close down completely. The cost of full restructuring was estimated at CFAF 7-11 billion.

Perhaps the greatest difficulty will be convincing private investors of the government's commitment to private decision-making. After years of struggling in an environment dominated by government controls and competition, private investors are chary of investing in areas long considered the government's domain. It takes time to build their confidence. They require assurances that the direction of the reforms are set and the pace is steady. More practically, they require clear and stable rules governing private operations in particular sectors.

USAID's Strategy

The CDSS states USAID's immediate objective as participation "in a cooperative effort with the GOS and other donors to restructure the Senegalese economy and lay the groundwork for positive growth." The goal is "a positive per capita rate of increase in GDP."

To achieve this goal, USAID's strategy is to support Senegal's shift from a state-controlled economy to an economy increasingly governed by private decision-making in a market-driven environment. In agriculture, the focus is on the implementation of the new agriculture policy, on the effort to promote domestic cereals production and to privatize internal marketing and import of cereals, and on decontrol of imports and agriculture inputs. In industry, USAID supports the new industrial policy aimed at increasing the competitiveness of Senegalese production by removing tariff and quantitative protections, privatizing government corporations, and easing restrictions on labor.

Through program support, USAID encourages the steady pace towards a liberalized environment for private business to stimulate private operators in supply and marketing of agricultural inputs, to encourage new investors in industry and force improved efficiency for existing operations, and to increase the productivity of the informal sector. Through project assistance, the strategy is to increase the use of private networks in key areas of agriculture-related marketing and environmental protection and to increase the role of the private sector in health and family planning. It will strengthen the capacity of the private sector to play a role by increasing its access in three areas: credit, training and technology.

Program Support for Policy Reform: Non-project assistance includes the Economic Support Program Grant (FY 86 ESF-IV $12.5 million, FY 87 ESF-V $11.5m, FY 88 ESF-VI $10 million), the Senegal Africa Economic Policy Reform (AEPRP) Grant (FY 86 $15.0 million), and the PL 480 Title I program loan (FY 86 $9.5 million, FY 87 $10 million, FY 88 $5 million). These programs provide budget support for the government's policy reform program and encourage focus on specific objectives through conditionality, self-help measures, and specific uses for local currency proceeds.

The ESF funds, provided as cash transfers, have aimed at liberalization of the agricultural sector. The government has shifted responsibility for distribution of agricultural inputs to the private sector. It has eliminated subsidies to the peanut oil pressing firms, ended its management of peanut seed stocks, and opened cereals marketing to private traders.

AEPRP I supports a package of tax and tariff reforms aimed at increasing the mobilization of domestic resources. Since 1986 the government has reduced the average level of tariffs by 40 percent, narrowed the number of goods affected, and removed quantitative restrictions on imports (except for those covered by special agreements). Counterpart funds are being used to reduce government arrears on payments to private firms. The tax code is now being reviewed, and the government is trying to negotiate an end to special agreements that exempt certain businesses from tax. It is trying to expand the tax base and is strengthening tax and customs administration. Under an AEPRP-II the Mission plans to negotiate conditionality on banking sector reform and will finance technical assistance for restructuring and privatization of publicly owned banks.

PL 480, through self-help measures and local currency, reinforces the Mission's dialogue with the government on its efforts to shift responsibilities to the private sector. One of the first self-help measures, for example, was the removal of restrictions on private marketing and transport of local cereals. Subsequently, the government lifted all restrictions on purchase, transport, and storage of local production. Another is the progressive elimination of fertilizer subsidies and encouragement of private sector fertilizer distribution.

<u>Project Assistance for Implementation</u>: New Mission projects are designed to engage the private sector in implementation of activities in the Mission's priority areas --agriculture, health and natural resources management. They seek to use the private sector in areas where the government is beginning to shift responsibility for services to the private sector. Because the private sector is often undeveloped in these areas and because the role private investors or traders are being asked to assume is relatively new, the targetted activities are high risk in the short term. There is, however, no choice in the long term. Senegal must delegate the responsibility for delivery of agriculture inputs and marketing of production to the private sector. The government cannot afford to supply all health care needs. Reforestation can only take place with significant private involvement. Management of water must be carried out by private users, supported by private services for irrigation development, operations and maintenance.

o Agriculture Production Support: The $20 million project aims at the development of a private seed multiplication program and increased private processing, distribution and marketing of cereals. It includes a $9 million credit component for agricultural input suppliers and production marketing to be run through local banks.

o Reforestation: The $10 million project encourages the development of private tree nurseries and plantations by working with private individuals, communities, and local organizations to demonstrate the benefits of agro-forestry, e.g. increased yields and tree products as cash crops.

o Irrigation and Water Management: The $8.5 million project will utilize local private firms for design, construction, and rehabilitation of irrigation systems in the Bakel area of the Senegal River Basin. This will involve building private sector capacity to provide irrigation services to local farmers.

o Southern Zone Water Management: The $18 million project now in design focuses on strengthening the capacity of local, private water-user

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organizations to build and maintain small anti-salt and water retention dikes and contour berms to reclaim land and to increase agricultural production. Local private sector firms will be used for dike and berm construction.

o Family Health and Population: The $20.6 million project includes a $1.5 million private sector component to encourage private companies to include family planning as part of health services made available to employees.

Direct Assistance to Develop the Private Sector: The Mission is also providing direct assistance, both program and project, to strengthen services to the private sector in three areas: credit, technology transfer and training. The most important of these areas is credit which the Mission considers the major constraint on private sector growth. It has two credit projects already underway--Community and Enterprise Development and Agriculture Production Support. It is examining other initiatives as well and is preparing both policy and direct assistance to speed banking sector reform under AEPRP II.

The sectoral focus for the direct assistance is agriculture and agriculture-related industrial development. This is based on the premise that Senegal's near-term growth must come for improved agriculture and a more dynamic agroprocessing industry. These are the areas that hold Senegal's greatest potential and comparative advantage.

Credit: Senegal suffers from an ailing and unresponsive banking sector. The country's banks face a liquidity crisis brought on by state targeting of loans, poorly performing loans, lack of internal controls, and rapidly deteriorating portfolios. Four banks in which the government has substantial interests have $367 million in bad debt. Credit available to the private sector has steadily diminished. During the 1970's private borrowing represented 24 percent of total credit. By the mid-1980s this had dropped to five percent, virtually all short-term. The lack of credit is a serious, perhaps the most serious, constraint on private sector development.

The Mission has already begun efforts to improve access to credit for small and medium-sized businnesses and for agriculture-related traders. Under its Community and Enterprise Development Project, the Mission is experimenting with approaches to small enterprise credit. The project has made 175 loans to small enterprises during the past year at interest rates--24 percent-- well above the formal commercial rates. With a default rate of less than five percent, the project now faces the daunting challenge of using the lessons it is learning to convince private bankers to take up small enterprise lending or to create a new and independent structure for such loans. The goal is the institutionalization of an approach to small enterprise credit through a private self-sustaining operation. Options being examined include a mutual society, credit union, private bank and NGO.

The Agriculture Production Support Project Provides funds through commercial banks for direct lending to traders supplying agriculture inputs or to purchasers of agriculture production. Technical assistance to formulate and implement reform of the banking sector itself will be prepared under AEPRP II. Through the Common Fund, the Mission is working with other donors to establish a system of credit for cereals-related lending. It is examining the possibility of credit through an approach similar to the model developed under the Agriculture Production Support Project, through the Community and Enterprise Development Project or through credit cooperatives.

At the same time, the Mission has been active in discussions between the GOS and the donor community on banking sector reform. It has participated in policy meetings and prepared comments on proposed reforms. It is proposing technical assistance to banks on inspection and supervision, credit allocation and loan recovery as part of AEPRP II.

Training: The second area in which the Mission is making a sustained effort to strengthen the private sector is in training. Through the Sahel Regional Financial Management Project we are providing training in financial management to private bakeries and to the local accounting association. We are exploring the establishment of a linkage between the CESAG, the regional management training center for West Africa, and an American management training institution. We are looking at the possibility of encouraging CESAG to develop a capacity for small enterprise training and development which would institutionalize some of the curriculum and training methods developed under the Community and Enterprise Development Project. And we have included both short and long-term training for the private sector in our Country Training Plan.

Technology Transfer: Under the Technology Transfer project, the Mission is exploring approaches to transfer appropriate technologies to Senegal's private sector. It has imported water buffalo to test their suitability for meeting the animal traction needs of small farmers. It is exploring processing of traditional crops such as millet, cowpeas and fruit. An area of growing interest is work with the Food Technology Institute on the adoption of food processing technologies by small and medium entrepreneurs. During the past year, the Mission has been exploring ways to encourage private mango drying businesses. We expect to continue these efforts in the next two years under an amendment to the Technology Transfer Project. The principal focus of that amendment will be the use of appropriate technologies in agro processing and marketing, one of the few areas of industry which appears to hold potential for small and medium-sized businesses.

Next Steps

Under our current program we will continue to provide assistance for private sector development concentrating on (1) policy--setting the environment for a dynamic private sector; (2) implementation--getting the private sector involved in agriculture, natural resources management and health and family planning, our key areas of concern; and (3) direct assistance to the private sector through credit, training and technology transfer focusing first on credit and on development of small and medium-sized companies in agro-related industries.

During the next year we are planning a number of steps to refine and advance that strategy:

1. Assistance to the banking sector (fourth quarter, FY 88): Our major new initiative will be banking sector reform. We are convinced that a concentrated effort to remove the constraint on credit and increase the responsiveness of the banking sector is the best single investment we can make to spur private sector development. We will explore financial assistance in support of privatization and reform along with technical assistance to banks in inspection and supervision, credit allocation and loan recovery to be funded as part of AEPRP II. Technical assistance to banks under AEPRP II would support efforts on credit development through APS and Community and Enterprise Development Projects. It would also lend practical strength to policy efforts to reform the banking sector.

2. Private sector needs assessment (fourth quarter, FY 88): in June and July, with the Bureau's assistance we will undertake a private sector training needs assessment. The assessment will analyze manpower constraints on private sector development and the resources, public and private, in-country and abroad, to address them. It will look at training in areas such as accounting, management, finance, marketing and entrepreneur development.

   The study also will provide context to our early discussions with CESAG, the regional West Africa management training institution, and with other public and private institutions on the possibility of institutionalizing the capacity for entrepreneurial training. Senegal's informal and small enterprise sector holds real promise. The informal sector now provides three times the number of jobs as the formal sector. Unencumbered by the statist control which has affected formal companies, informal entrepreneurs have operated with a verve that has given Senegalese traders and businessmen a world-wide reknown. How to capitalize on that creativity, help small businessmen become larger and effectively link the informal sector to formal operations in a newly liberalized economy remains a major challenge. The training being carried out in the Community and Enterprise Development Project holds promise. Other efforts at entrepreneur training, most notably that being done by the Center for Entrepreneur Development in Ahmedabad and MSI in the Gambia, may be possibilities. The EDI at the World Bank has made some efforts to graft the CED program to Senegalese institutions. The private sector training needs assessment will help us examine that experience and various alternatives.

3. Assistance in Employment and Enterprise Policy to the Ministry of Finance (fourth quarter, FY 88: We are exploring possible assistance to the Ministry of Finance in preparing studies on a wide range of issues--trade and industrial policy, tax, labor regulation, investment code--that affect private sector development. We have cabled AID/W about the possibility of buying in to an existing project such as S&T's Employment and Enterprise Policy Analysis Project. We are also considering the preparation of case studies based on clients under the Community and Enterprise Development Project which can provide examples of specific policy constraints on small and medium-sized enterprises and might eventually be used in training materials for a small business development course.

4. Development of a PVO strategy and co-financing project (first-third quarters FY 89): We are looking at local and US PVOs in Senegal as possible intermediaries for a USAID effort to help develop the informal sector. During the next few months we will be reviewing our PVO program and developing a PVO strategy as part of our private sector program. Again, the Community and Enterprise Development Project through its work with PVOs and its credit efforts is providing useful information both on the problems of small entrepreneurs and on the ability of PVOs to help deal with them. In addition, three AID/W-funded matching grants to US PVOs include private sector components may produce useful approaches to PVO small enterprise development. We will begin work on the project implementation document for a co-financing project with PVOs in September. We are considering aiming the project particularly at those PVOs interested in income generating projects and development of small enterprises.

5. Assistance to agroprocessing (ongoing): Continuation of efforts under the Transfer of Technology Project to provide technical and marketing assistance to private operators.

6. Private sector strategy assessment (first quarter, FY 89): We are considering requesting AID/W assistance next fall to undertake a private sector strategy review. The review will provide a broad overview of the major constraints on private sector development against which to measure our current strategy. It will survey major policy areas: tax, trade and industrial policies, licensing, restrictions on labor. It will look at services available to private businesses--legal, marketing, credit, accounting and technology transfer and describe ways in which those services can be improved. It will help us to make adjustments in our portfolio and to design the work anticipated in credit and the banking sector and in assistance to small and medium-sized business, particularly in agro-related industry. Finally, it should provide insights into areas for future consideration, perhaps as part of the next CDSS.

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