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THE ROLE OF TECHNICAL ASSISTANCE IN PRIVATE SECTOR DEVELOPMENT IN SOUTHERN AFRICA

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FOREWORD

During the TICAD Asia-Africa Trade and Investment Conference (TICAD-AATIC) held in Tokyo in November 2004, the importance of trade and investment promotion between the two regions in order to achieve sustainable economic development of Africa was confirmed, and various public support schemes and involvement of private sectors were discussed. At the closing of the Conference, the Japanese government presented four focal points of the development assistance towards Africa in the area of trade and investment. These are:

(1)Formulation of Appropriate Policy (Identification and development of comparative advantages);
(2)Product Development (Creation of business based on comparative advantage);
(3)Empowerment of SMEs (Support for business start-ups, Establishment of financial structure); and
(4)Promotion of Social Contributions by Private Enterprises.

Based on the above initiative, this Study aims to identify and analyse ways to promote FDI and industrial development in general in the Southern African region, for each country and under the framework of SADC. The Study also aims to clarify the future directions of Japanese technical assistance in order to effectively assist in this area. In order to achieve these aims, the Study investigates the overall investment climates of 15 Southern African countries (South Africa, Zambia, Tanzania, Madagascar, Malawi, Angola, Mozambique, Botswana, Mauritius, Dem. Rep. of Congo, Namibia, Zimbabwe, Lesotho, Swaziland, and Seychelles), and propose some direction of Japanese cooperation for South Africa, Zambia, Tanzania, Madagascar, Malawi, Angola, and Mozambique. The study was conducted on a contract research basis with UFJ Institute and Japan External Trade Organization for the internal use of Japan International Cooperation Agency (JICA). Accordingly, the contents of this report do not necessarily reflect the current official views or opinions of JICA.

In conducting the Study, many relevant agencies and organizations in the 15 countries, including government agencies, business organizations and private enterprises, have contributed to the Study. Without their support, we could not have come up with this final report. We greatly appreciate their cooperation.

October, 2005

Tadashi IZAWA
Vice-President
Japan International Cooperation Agency

ACRONYMS and ABBREVIATIONS

ACP	African Caribbean and Pacific
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency
ANIP	National Private Investment Agency
BCM	Central Bank of Madagascar
BEE	Black Economic Empowerment
BESA	Board Exchange of South Africa
BOT	Bank of Tanzania
BoZ	Bank of Zambia
CAS	Country Assistance Strategy
CIA	Central Intelligence Agency
CDC	Commonwealth Development Corporation
CMA	Common Monetary Area
COMESA	Common Market of Eastern and Southern Africa
CPI	Investment Promotion Centre
CPLP	Community of Portuguese Speaking Countries
CSR	Corporate Social Responsibility
DBSA	Development Bank of South Africa
DFID	UK Department for International Development
DRC	Democratic Republic of Congo
DTI	Department of Trade and Investment, South Africa
EAC	East African Community
EC	European Commission
EIU	Economic Intelligence Unit
EPZ	Export Processing Zone
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	German Technical Cooperation
HIPC	Heavily Indebted Poor Countries
HIV	Human Immunodeficiency Virus
IDA	International Development Association
IDC	Industrial Development Corporation
IDZ	Industrial Development Zones
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
LuSE	Lusaka Stock Exchange
JSE	Johannesburg Stock Exchange
LDC	Least Developed Countries
MIGA	Multilateral Investment Guarantee Agency
MIPA	Malawi Investment Promotion Agency
NDC	National Development Corporation
NEPAD	New Partnership for Africa's Development
NGO	Non-Governmental Organizations
ODA	Official Development Assistance
OPIC	Overseas Private Investment Corporation
PPP	Public-Private Partnerships
PRGF	Poverty Reduction and Growth Facility

PRSP	Poverty Reduction Strategy Paper
PTA	Preferential Trade Agreement
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARB	South African
SARS	South African Revenue Services
SDI	Spatial Development Initiatives
SOE	State Owned Enterprise
SME	Small and Medium Enterprise
SMME	Small, Medium and Micro Enterprises
STD	Sexually Transmitted Diseases
TAZ	Tanzanian Assistance Strategy
TIC	Tanzanian Investment Centre
TISA	Trade and Investment South Africa
TNC	Transnational Corporations
TNDP	Transitional National Development Plan
UK	United Kingdom
UNAIDS	Joint United Nations Programme on HIV/AIDS
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations International Children's Emergency Fund
US	United States of America
USAID	US Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization
ZIC	Zambian Investment Centre

TABLE OF CONTENTS

1. SOUTH AFRICA

1.1. Trends of Macro Economy, Industry, Trade and Industry

1.1.1. Macro Economy

Although South Africa's economy is in many areas highly developed, the exclusionary nature of apartheid and distortions caused in part by the country's international isolation until the 1990s have left major weaknesses. The economy is now in a process of transition as the government seeks to address racial inequalities, to stimulate growth and to create jobs. Businesses, meanwhile, are becoming more integrated into the international system and foreign investment has increased dramatically over the past several years. Nevertheless, the economic disparities between population groups are expected to persist for many years, remaining an area of priority attention for the government.

The Government of South Africa demonstrated its commitment to open markets, privatization and a favourable investment climate through its release of the crucial *Growth, Employment and Redistribution (GEAR)* strategy - the neo-liberal economic strategy to cover 1996-2000. The strategy has had mixed results. It brought greater financial discipline and macroeconomic stability but has failed to deliver in key areas. Formal employment continued to decline, and despite the ongoing efforts of black empowerment and signs of a fledgling black middle class and social mobility, the country's wealth remains very unequally distributed along racial lines.

However, South Africa's budgetary reforms such as the *Medium-Term Expenditure Framework* and the *Public Finance Management Act*-which aim at better reporting, auditing, and increased accountability-and the structural changes to its monetary policy framework-including inflation targeting-have created transparency and predictability, and are widely acclaimed. Trade liberalization also has progressed substantially since the early 1990s. South Africa has reduced its import-weighted average tariff rate from more than 20% in 1994 to 7% in 2002. These efforts, together with South Africa's implementation of its World Trade Organization (WTO) obligations and its constructive role in launching the Doha Development Round, show South Africa's acceptance of the free market principles.

South Africa's GDP is expected to increase gradually during the next few years, and the government recently revised its 2005 estimated growth upwards to 4.3%. Annual GDP growth between 1994 and 2004 averaged 3.0%. In 2003, real GDP growth slowed to a rate of 2.8%, but increased to 3.7% in 2004. The government estimates that the economy must achieve growth at a minimum of 6% to offset unemployment, which is estimated at 28%, although unofficial sources put it as high as 41%.

One of the great successes of the ANC government has been to get consumer inflation, which had been running in the double digits for over 20 years, under control. The South African government cut the inflation rate to 4% in 2004, and the rand appreciated 39% from 2002 to 2004. The South African Reserve Bank increased interest rates. This, along with the 28% rand appreciation in 2003 led to a reduced consumer inflation of 5.8%.

The government's 2005 budget calls for a moderate increase in spending to promote faster growth and poverty alleviation, while curbing budget deficits. Budget highlights include the following:

(1) R6.8 billion in tax relief for individuals;
(2) People earning below R35 000 (R60 000 for over 65s) will not pay personal income tax;
(3) A R40 increase in the R780 maximum old age, disability and care dependency grant, plus a R10 hike in the R180 child support grant;
(4) Scrapping of transaction tax on debit entries to credit card and bank accounts;
(5) Fuel levy on petrol and diesel to rise by 5c on April 6, and a 5c hike in the Road Accident Fund levy;
(6) Tax relief of R1.4 billion for small business to free up resources for growth;
(7) Further tax relief has been proposed where capital expansions are to be financed by

means of the issue of equity shares; and

(8) A total of R1 billion has been made available for a new micro agriculture finance scheme for emerging farmers and beneficiaries of land reform.

The Department of Agriculture receives additional allocations of R200 million, R300 million and R450 million in the medium term to support the agricultural black economic empowerment initiative and the micro-agriculture financing scheme.

South Africa is a member of the Southern African Customs Union (SACU) and the Southern African Development Community (SADC). In August 1996, South Africa signed a regional trade protocol agreement with its SADC partners. The agreement was ratified in December 1999, and implementation began in September 2000. It intends to provide duty-free treatment for 85% of trade by 2008 and 100% by 2012.

The government of South Africa welcomes foreign investment as a key driver for the country's economic development and integration into the global economy. In 2004 the government announced a goal of investment reaching 25% of GDP by 2014. South Africa has liberalized trade and developed its competitiveness by lowering tariffs, abolishing most import controls and reforming the regulatory environment.

South Africa has rich mineral resources. It is the world's largest producer and exporter of gold and platinum. It also exports a significant amount of coal. During 2000, platinum overtook gold as South Africa's largest foreign exchange earner. Value-added processing of minerals to produce ferroalloys, stainless steels and similar products is a major industry and an important growth area. The country's diverse manufacturing industry is a world leader in several specialized sectors, including railway rolling stock, synthetic fuels, and mining equipment and machinery. Primary agriculture accounts for about 4% of the gross domestic product. Major crops include citrus and deciduous fruits, corn, wheat, dairy products, sugarcane, tobacco, wine and wool.

Table 1.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	20.0	25.0	31.7	39.7	41.9	42.9	44.0	44.8	45.3	45.8
Population ages 0-14 (% of total)	41.4	40.3	38.3	34.7	33.4	32.9	32.4	32.2	32.1	32.0
Population ages 15-64 (% of total)	54.8	56.2	58.3	60.8	61.8	62.4	62.9	63.2	63.4	63.6
Population ages 65 and above (% of total)	3.8	3.5	3.3	4.5	4.8	4.7	4.7	4.6	4.5	4.4
GDP (constant billion 2000 US$)	51.7	81.5	102.0	114.8	121.2	123.7	128.0	131.5	136.1	138.7
GDP growth (annual %)	6.3	3.6	1.4	1.8	0.8	2.0	3.5	2.7	3.6	1.9
GDP per capita (constant 2000 US$)	2,562.9	3,253.8	3,226.5	2,889.6	2,892.9	2,881.3	2,909.6	2,933.5	3,002.3	3,025.7
Official exchange rate (LCU per US$, period average)	0.7	0.8	1.9	4.4	5.5	6.1	6.9	8.6	10.5	7.6
Inflation, consumer prices (annual %)	2.8	10.6	14.7	9.0	6.9	5.2	5.3	5.7	9.2	5.9
Money and quasi money (M2) as % of GDP	58.0	55.6	50.4	49.8	53.4	55.2	54.3	54.9	56.8	60.7
Real interest rate (%)	4.2	-2.5	2.3	7.6	13.9	11.1	6.8	5.5	5.2	8.5
Foreign direct investment, net inflows (% of GDP)	0.0	0.0	-0.1	0.7	0.4	1.1	0.8	6.4	0.7	0.5
Foreign direct investment, net inflows (% of gross capital formation)	0.0	0.0	-0.6	4.1	2.5	7.2	4.9	43.6	4.4	3.1
Agriculture, value added (% of GDP)	9.6	7.1	5.3	3.9	3.6	3.4	3.2	3.5	4.1	3.8
Industry, value added (% of GDP)	38.3	41.3	42.8	34.1	32.2	31.0	31.1	31.5	32.2	31.0
Manufacturing, value added (% of GDP)	21.9	21.6	23.0	20.4	19.1	18.7	18.6	18.6	19.4	18.9
Services, etc., value added (% of GDP)	52.1	51.6	51.9	62.0	64.2	65.5	65.7	65.0	63.7	65.2
General government final consumption expenditure (% of GDP)	11.5	14.3	17.9	19.3	19.0	18.6	18.7	18.9	18.7	19.1
Household final consumption expenditure, etc. (% of GDP)	62.2	55.1	55.2	61.8	63.3	62.9	62.8	62.6	61.7	62.4
Final consumption expenditure (% of GDP)	73.6	69.4	73.1	81.1	82.3	81.5	81.5	81.5	80.4	81.4
Gross capital formation (% of GDP)	23.4	27.9	22.4	16.4	16.6	15.9	15.5	14.6	15.9	16.8
Exports of goods and services (% of GDP)	26.6	28.7	27.2	24.0	25.7	25.7	28.9	31.0	33.8	28.2
Imports of goods and services (% of GDP)	23.7	25.9	22.7	21.5	24.6	23.1	25.9	27.1	30.0	26.4
Gross domestic savings (% of GDP)	26.4	30.6	26.9	18.9	17.7	18.5	18.5	18.5	19.6	18.6
Gross capital formation (% of GDP)	23.4	27.9	22.4	16.4	16.6	15.9	15.5	14.6	15.9	16.8
Food exports (% of merchandise exports)	-	19.8	7.8	9.2	12.1	10.2	8.5	8.4	10.6	9.9
Food imports (% of merchandise imports)	-	4.9	5.5	6.1	5.2	5.4	4.7	4.6	5.0	5.0
Agricultural raw materials exports (% of merchandise exports)	-	6.4	3.4	3.5	3.8	3.2	3.4	2.4	3.1	2.8

Agricultural raw materials imports (% of merchandise imports)	-	3.5	2.3	1.9	1.5	1.5	1.5	1.4	1.5	1.4
Ores and metals exports (% of merchandise exports)	-	14.7	7.9	10.3	9.6	21.3	10.8	9.3	11.3	19.2
Ores and metals imports (% of merchandise imports)	-	2.6	1.9	1.5	1.5	1.7	1.5	1.1	1.7	2.0
Fuel exports (% of merchandise exports)	-	3.5	6.5	8.1	7.7	9.7	10.1	8.2	12.3	9.8
Fuel imports (% of merchandise imports)	-	0.4	0.4	7.1	8.4	10.2	14.4	15.5	12.5	11.9
Manufactures exports (% of merchandise exports)	-	31.6	18.5	48.2	53.7	55.0	54.3	59.4	62.6	58.2
Manufactures imports (% of merchandise imports)	-	83.5	69.4	74.1	70.0	73.0	69.7	68.4	70.4	70.3
Aid per capita (current US$)	-	-	-	10.3	12.3	12.6	11.1	9.6	11.1	13.6
Total debt service (% of exports of goods and services)	-	-	-	11.7	12.1	12.0	9.8	11.4	12.3	9.0
Total reserves in months of imports	2.4	3.0	1.5	1.6	1.8	2.5	2.4	2.5	2.5	2.0

Source: The World Bank (2005), *World Development Indicators: 2005*

1.1.2 Industry

South Africa's economy depended on agricultural production that was started by white European settlers. However, the discovery of mineral resources such as diamonds and gold made it possible to develop an socio-economic infrastructure of high-quality and modern domestic industries such as mining, manufacturing, financial services as well as processing agricultural product, which became the foundation of the nation's economic development. At the same time, the concentration of political power and economic interests in the white citizenry, which was a mere tenth of the population, was systemized through the policies of apartheid establishing a two-tier domestic economy. Since the 1970s when many African countries became independent, the South African government's adherence to apartheid and its manoeuvres to destabilize the surrounding nations have invited international criticism and economic sanctions, intensifying its isolation from global markets and inducing capital flight. It is ironic that this accelerated the growth of import substitution industries and led to a more sophisticated and diversified domestic industry as well as the accumulation of capital and technology during the same period. After apartheid-related laws were repealed in 1991 and the Mandela administration came to power in the all-race democratic election of 1994, economic sanctions were successively lifted and the nation's return to the international community immediately moved forward. The result has been that while on the one hand, there have been advances of new and renewed forays of foreign capital as well as smoother access for companies to the global market, on the other hand the nation's industries and companies have come to be exposed to international competition. The government has had a difficult task of reconciling sometimes conflicting economic and industrial policies, namely increasing the competitiveness of domestic industries through economic and market liberalization, and improving the employment and income of low-income black groups which account for 80% of the population.

Looking at the GDP ratios of South Africa's principal industries, the country's industrial structure resembles that of a developed nation with downward trends in agriculture to 4%, manufacturing and mining to 32% (the manufacturing industry declined from 24% to 19%), but with the ratio of services rising to 64%.

South Africa is the largest agricultural producer country in the region where commercial farming, which is land-, capital- and technology-intensive, and small-scale traditional farming for families and domestic consumption are intermingled. Besides agricultural products such as maize (7.1 million tons produced in 2001), wheat (2.13 million tons), sugarcane (23.90 million tons) , fruits (4.76 million tons) and vegetables (2.05 million tons), the country produces a large amount of other products including cattle (2.79 million head) , sheep and goats (10.71 million head) and poultry (700 million birds). It has a thriving fishing industry with an annual catch of 600 thousand tons including sardines, horse mackerel, sea bream, cod and shellfish. The forestry industry revolves around one of the world's largest artificial forests, producing materials for paper and pulp. Blessed by temperate weather, the nation is a net exporter of agriculture and forestry products (including processed goods, 13.5% of exports)

The mining industry (including processed metals) has been South Africa's mainstay for a long time. The nation boasts the world's top class production in gold (395 tons in 2002), chromium (5.50 million tons), platinum (229 tons) and diamonds (11.17 million carats). With flourishing production of iron ore, manganese and copper, raw materials and primary processed goods destinated to base metal products accounted for half of 2002 exports. South Africa's gold, diamond and platinum companies have leverage in all global markets, and since South Africa's return to the international community, the conglomerate group known as "Mining House" has gradually been partitioned, with mergers and acquisitions of other companies in the same industry and for mine development being actively pursued not only in Africa but throughout the world. In this same sector and through joint ventures with foreign firms, continued investment has targeted the development of new mining concessions and resource processing. South Africa is also a world coal producer country with an annual output of more than 200 million tons, which supports its low cost massive electric production.

Other than the above-mentioned metal and agricultural processing industries, manufacturing is the most diversified, technologically capable and mature in the region, integrating sub-sectors for exports to world market as well as surrounding countries and fulfilling domestic demand even under economic sanctions. Of these, the automobile sector, utilizing the independent *Motor Industry Development Programme (MIDP)* after United Nation's economic sanctions were lifted in 1993, has aimed to successively reinstate and expand the investments of US, European and Japanese automakers. Since 2000, the application of FTAs with EU countries in the frame of TDCA and the *African Growth Opportunity Act (AGOA)* to the US has made South Africa one of the world's strategic production centres. While some manufacturing industries, such as the chemical sector (which takes advantage of abundant domestic and regional materials such as coal) maintain a certain technological competitiveness, other manufacturing industries such as electric appliances do not have the relative competitiveness that other advanced countries and Asia have, due to its limited demand in the regional market and its exposure to fierce competition from low-cost imports.

In the service industry, the public service sector privatized since the end of the 1990s following government’s open market policy has become host to foreign capital inflows mainly in telecommunications, transportation and energy sector. The sector, with its advantage of having high capital and technological strength, has also actively launched regional private sector infrastructure development and management projects. The distribution industry has continued its expansion throughout the entire region creating new outlets for the nation's products. This is being supported by the above-mentioned transportation companies and the financial sector. South Africa's financial sector, with its holding companies for a conglomerate of companies and institutions for the management, investment and financing of capital, has since long ago boasted providing personnel, know-how and service that meets international standards. Recently, the role that South African financial institutions have played in nurturing and expanding the region's private financial sector has been great. Lastly, with respect to tourism, the number of tourists in 2002 was 6.55 million or 6 times that of 1990 with tourism revenues reaching US$2.7 billion, a three-fold increase. South Africa has an infinite number of tourist spots, substantial lodging facilities and a high-quality transportation infrastructure, which are also indispensable sources for domestic employment and foreign currency earnings, and are expected to contribute to the nurturing of industries in neighbouring countries and visits by tourists to these countries as well.

1.1.3 Trade and Investment

(1) Trade

South Africa has benefited from rising commodity prices and declining interest rates worldwide. But the relative strength of the rand and the weakness of the dollar have impacted negatively on exporters and import competing industries. Gold and diamonds remain the country’s most valuable export commodities, while the two fastest-growing major export industries are aluminium and platinum. South Africa’s export base is, however, diversifying rapidly with successes apparent in processed agricultural goods, automobiles and industrial machinery, encouraged by export credit reinsurance and other export promotion programmes offered by the Department of Trade and Industry.

The US, UK and Germany are the three biggest trading partners in both exports and imports. With the US, South Africa is a beneficiary of the *Generalized System of Preferences* and the AGOA. With the European countries, *Trade, Development and Cooperation Agreement* in 2000 established a free trade agreement. Due to this, South Africa will grant duty-free access to 86% of EU imports over a period of 12 years, while the EU will liberalise 95% of South Africa's imports over 10 years.

South Africa also exports to the rest of Africa (about 16% of the total export in 2002), however, import from Africa is very limited amount (only 4% of the total import in 2002). With the launching of the *SADC Free Trade Agreement* in 2000, South Africa has undertaken fast-tracking of the abolition of import tariffs on goods from the SADC region. Tariffs on 65% of imports had been lifted in 2000 while 95% of imports from the region have become duty free by 2005.

Table 1.2: Trade tendency and main partners

（US$ million）

			1998	1999	2000	2001	2002
Export			34,403	33,701	36,594	34,993	35,392
Import			32,855	30,264	33,066	30,894	31,843
Main trading partners							
	Export	United Kingdom	2,080.91	2,386.07	2,257.50	2,487.17	3,825.08
		United States	1,875.66	1,913.19	2,406.83	2,338.23	3,802.45
		Germany	1,478.85	1,950.37	1,898.76	1,970.67	2,705.80
	Import	Germany	4,082.32	3,881.15	3,936.18	4,106.25	4,531.36
		United States	3,849.25	3,621.37	3,490.28	3,310.66	2,777.72
		United Kingdom	2,928.69	2,514.45	2,519.86	2,336.92	2,657.53

Source: World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

1) Inward FDI

Between 1998 and 2003, the yearly amount of FDI into South Africa has fluctuated. In particular, there was a huge jump in 2001, when Anglo American purchased De Beers shares which was mainly held in South Africa. In 2002 and 2003, it shifted around US$ 750 million, which surpass other SADC countries except for Angola.

Table 1.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
561.1	1,502.3	887.9	6,788.7	756.7	762.5

Source: UNCTAD, FDI On-line.

It is estimated that there are nearly 700 American companies (including subsidiaries and joint ventures, local partners, agents, franchises and representatives) doing business in South Africa. The second and third highest numbers of companies per country are from Germany and the UK respectively.

Australia was the leading source of FDI in the fourth quarter of 2004 contributing over R5.2 billion. The second largest investing country in the quarter was the UK, bringing in more than R1 billion. Other contributions included a smaller but nonetheless significant expansion of R75 million by the Dialogue Group into the vibrant South African call centre industry.

Table 1.4: FDI by country: Fourth quarter 2004

Country	Total Rm	Total US$m
Australia	5,234	909
UK	1,075	185
Kuwait	600	94
Sweden	344	56

India	40	6
Canada	35	5
Italy	-42	-7
Malaysia	-2,640	-436
USA	-3,789	-626
TOTAL	**856**	**187**

Source: The BusinessMap Foundation

As for the industrial sectors, the bulk of FDI (70%) are in the mining and metals sector. There are increased FDI in the tourism sector which has recorded R393 million (US$61.5 million) in new investment in theme parks, hotels, guest-houses and game lodges in the 2002/03 fiscal year. The South African Automotive and Components industry is on a growth path and is well placed for investment opportunities. Investment by vehicle makers is forecasted to reach a five-year high of R3.5 billion in 2004. Four major commercial banking groups who provide retail and investment banking services dominate the South African banking industry. The European, Malaysian and US banks that have banking licenses have so far concentrated on corporate as opposed to retail banking. Foreign banks are gaining market share by charging aggressive lending margins.

The following companies have invested in excess of R1 billion in South Africa since 1994:

- Canada-Placer Dome
  Placer Dome is one of the world's largest gold mining companies. In South Africa, Placer Dome became the first foreign investor in the mining sector following democratization with the purchase of 50% of the South Deep mine. South Deep is situated in the Witswatersrand Basin, the world's most productive gold mining region. In 2004 South Deep produced 210 000 ounces of gold for Placer Dome and accounted for 5% of revenue.

- Denmark-AP Moller
  Apart from shipping, the A.P. Moller-Maersk Group is engaged in exploration of and production of oil and gas, shipbuilding, aviation, industry and supermarkets. The A.P. Moller Group employs over 60 000 people worldwide and has offices in more than 125 countries. Former South African national carrier Safmarine was bought by AP Moller-Maersk in 1999.

- France-Lafarge
  Lafarge is the world leader in cement and roofing with locations in 75 countries and a workforce of 77 000 people. 2004 sales were €14.4 billion. Lafarge South Africa was formed following the take over of Blue Circle SA in 1998 and Blue Circle UK in 2001.

- Germany-BMW
  BMW Group operates in 150 countries with 23 production and assembly plants, in seven countries. Over the past three decades, BMW South Africa has moved from operating as a Completely Knocked Down (CKD) vehicle production plant, assembling vehicles with limited customisation possibilities for the local market, to a world class plant. This evolution is largely due to BMW's billion rand investment in the Rosslyn plant in the mid 90's. The investment, used to upgrade the production facility into one of the most modern in the world, brought Rosslyn in line with other BMW plants across the world and earned it the title of BMW World Plant Rosslyn. BMW recently announced the decision to invest a further R2 billion into the South African facility in preparation for the production of future models.

- Italy-Cirio (Del Monte)
  The R1.2 billion acquisition of Del Monte Royal Foods by Cirio of Italy was one of the biggest FDI deals in 2001. The South African company, Del Monte Royal, was bought out by Cirio in 2001 from the controlling shareholders, the Imerman family, and the company was delisted from the JSE Securities Exchange SA two months later. The acquisition made Cirio the sixth-largest food company in Europe.

- Switzerland-Movenpick Hotel
  Mövenpick Hotels & Resorts is an international Swiss premium hotel chain active in the 5-star resort hotel and 4-star business/airport hotel markets. In 1998 it acquired the majority of the South African hotel group Karos.

- UK-Billiton
  BHP Billiton is the world's largest diversified resources company with interests in aluminium, energy coal and metallurgical coal, copper, ferro-alloys, iron ore and titanium minerals, and substantial interests in oil, gas, liquefied natural gas, nickel, diamonds and silver. It has 35 000 employees working in more than 100 operations in approximately 20 countries. In South Africa BHP Billiton has a joint venture with London-based Rio Tinto plc for exploitation of placer mineral sands- Richards Bay Minerals. The joint venture is a leading producer of titanium slag, high purity pig iron, placer rutile and placer zircon. The company is based at Richards Bay on the Indian Ocean coastline in northern KwaZulu-Natal. Richards Bay Minerals has 2 100 employees and about 2 000 contractors. BHP's South Africa coal business, Ingwe, is the biggest coal producer in the country, employing about 8 500 people.

- Lonrho Plc
  The Lonrho group comprises companies active in the businesses of gold, platinum, copper and coal mining, agricultural activities including ranching and sugar production, production and retailing of textiles, brewing, agricultural equipment distribution, oil and gas production, freight forwarding and warehousing, printing and publishing including newspapers, ownership and management of properties, hotels and casinos.

- US-Caltex
  Caltex, a ChevronTexaco company, employs more than 6 000 people across Asia Pacific, the Middle East and Africa. Caltex Oil South Africa, has a network of over a 1 000 service stations. It constructed its own refinery in Milnerton, Cape Town, in the mid 1960's. The Caltex refinery remains one of the largest industrial undertakings in the Western Cape.

- US-Coca Cola
  Coca-Cola entered South Africa in 1928, when a bottling and distribution plant was established in Johannesburg, the first in Africa. According to a March 2000 study conducted jointly by the University of South Africa's and the University of South Carolina's business schools, Coca-Cola employs approximately 3% of South Africa's population. Approximately 700 000 people rely directly or indirectly on the distribution of Coca-Cola products, according to AFX European Focus.

- US-Dow Chemicals
  Dow provides chemical, plastic and agricultural products and services. With annual sales of US$40 billion, Dow serves customers in 175 countries. In 1997, Dow acquired control of Sentrachem in South Africa. Dow subsequently purchased Hoechst SA's interest in Safripol, restructured Agrihold into Dow Agrosciences, and is currently developing plans to establish a regional hub in Johannesburg for its African and Middle East interests.

- US-IBM
  IBM South Africa Limited (formerly Information Services Group Limited) through it's wholly owned subsidiary Information Services Management (Proprietary) Limited is IBM's exclusive representative in South Africa. In 1997 the company restructured itself in three major ways: (1) It acquired full ownership of International Outsourcing Services; (2) Disposed of non core associated companies; and (3) resized and re-aligned it's staff resources.

- Saudi Arabia-Oger

Saudi Oger is a construction company incorporated in Saudi Arabia which has diversified its activities into telecommunications, printing and business development. Saudi Oger is South Africa's third cellular provider Cell C's 60% shareholder. Saudi Oger invested nearly US$390 million to acquire the third cellular license and establish Cell C. One of the biggest FDI deals of 2001 was Saudi Oger's US$180 million investment in Cell C, the new cellular operator.

2) Outward FDI

South Africa has become an important direct investor in other SADC countries. The table below shows that South African investment ranged from 10% to 20% of GDP in Lesotho, Mauritius, Mozambique, Namibia and Swaziland during 1998-2002.

According to the June 2005 quarterly bulletin of the South African Reserve Bank, the assets of South African firms in Africa as a result of foreign direct investment amounted to R15.8 billion at the end of 2003. The total foreign assets (direct investment, portfolio investment and other investments) of South African subjects in Africa were R32 billion at the end of 2003.

Table 1.5: Investment from South Africa, Stocks, 1998-2002 (in % of GDP)

	1998	**1999**	**2000**	**2001**	**2002**
Angola	0.1	0.1	0.1	0.3	0.1
Botswana	7.0	3.3	3.1	3.3	2.4
DRC	0.8	0.4	0.3	4.1	0.2
Lesotho	10.6	21.3	29.4	29.5	11.7
Madagascar	0.6	0.1	0.0	0.0	0.0
Malawi	3.0	2.3	2.5	1.3	3.7
Mauritius	5.8	22.2	22.8	19.1	15.6
Mozambique	1.8	12.1	16.4	16.7	22.0
Namibia	10.1	8.7	9.2	7.5	10.1
Seychelles	0.4	0.0	1.3	3.0	2.0
Swaziland	23.0	21.5	20.1	6.5	5.3
Tanzania	0.5	0.2	0.3	0.7	0.7
Zambia	2.4	1.7	1.8	4.5	4.3
Zimbabwe	3.3	3.8	2.1	1.6	0.6

Source: Arora and Vamvakidis

In terms of South Africa's foreign assets relating to direct investment - Mozambique accounted for 32% of South Africa's total foreign direct investment in Africa. Mauritius accounted for 26% of South Africa's total direct investment in Africa. Namibia assets - as a result of foreign direct investment by South African firms - were 7% of South Africa's total direct investment in Africa.

Table 1.6: Foreign assets (foreign direct investment) of South Africa by selected countries
31 December 2003 (R millions)

	Botswana	Lesotho	Swaziland	Namibia	Zimbabwe	Mauritius	Mozambique	Zambia	Other	Total
Total Direct Investment	**551**	**204**	**937**	**1,151**	**2,033**	**4,106**	**5,071**	**415**	**1,369**	**15,837**
Public corporations	**0**	**0**	**0**	**0**	**0**	**0**	**4,392**	**0**	**0**	**4,392**
Equity capital	0	0	0	0	0	0	31	0	0	31
Reinvested earnings	0	0	0	0	0	0	1,388	0	0	1,388
Other capital	0	0	0	0	0	0	2,973	0	0	2,973
Private Banking sector	**102**	**17**	**19**	**318**	**0**	**1,537**	**0**	**0**	**0**	**1,993**
Equity capital	68	12	13	217	0	1,052	0	0	0	1,362
Reinvested earnings	34	5	6	101	0	485	0	0	0	631
Private non-banking	**449**	**187**	**918**	**833**	**2,033**	**2,569**	**679**	**415**	**1,369**	**9,451**
Equity capital	102	35	25	177	81	1,000	610	9	176	2,215
Reinvested earnings	239	129	775	385	1,514	1,397	3	317	748	5,507
Long-term Loan	0	0	2	2	5	4	4	0	391	408
Short-term Loan	108	23	116	269	433	168	62	89	54	1,322

Source: South Africa Reserve Bank, June 2005

Traditionally most of the direct investment by South African firms in other SADC countries has been resource related investments. However, in the last few years more and more investment in the other SADC countries has been market seeking.

Table 1.7: Selective prominent South African retail investments in the SADC since 1998

Year	Country	Investment	Investor	Type	Amount
2002	Angola	Shoprite/Megasave DC	Shoprite	New	R113m
2002	Malawi	Protea Hotel Rhyallsl	Protea	Expansion	$4,5m
2002	Madagascar	Champion supermarkets	Shoprite	M&A	Not known
2002	Mozambique	Vilanculos sanctuary	Jordan Properties	Privatisation	$20m
2002	Mozambique	Laurentina	SAB (78%)	M&A	Not Known
2002	Lesotho	Afri-Ski Mahlasela	Afri Ski & Leisure	New	$10m
2001	Angola	Coca Cola Bottling	SAB (45%)	New	$19m
2001	Zambia	Zambia Falls Convention Centre	Sun International	New	$56m
2001	Tanzania	Royal Palm Hotel	Legacy Hotels	New	$25m
2001	Malawi	Pep Stores	Pep Clothing	Withdrawal	R100m

Source: DBSA

1.2. Policy Issues Promoting FDI

1.2.1 Industrial Policies and Development Plans

Armed with a large population and resources, the accumulation of a certain amount of technology and capital as well as the existence of corporate groups possessing world class management techniques, South Africa is one of the few nations in the region able to respond to the globalizing world economy. However, reality shows that the disparity in income levels between its black and white citizens is still large, and in recent years, this gap has widened within the black community as well. The South African government's economic policies, which originally moved in the direction of demand-side economic growth through low income social capital improvements such as housing construction, have shifted toward the realization of supply-side sustainable growth emphasizing domestic industrial productivity and competitiveness. During this time, consistent fiscal policies have served to control inflation, stabilizing the macro-economic environment as well as fiscal income and expenditures, but there have been no indications that the critical employment situation will improve. With land appreciation and the increase in foreign currency reserves as well as the restoration of fiscal health, the government has embarked on a course to expand domestic demand and employment opportunities though renewed fiscal activism. Additionally, a new action agenda, *Black Economic Empowerment (BEE)*, was introduced promoting systemization on the popular level of income redistribution and increasing the ratio of black participation in corporate assets, employment and decision-making. As for external trade policy, together with the promotion of regional market integration based on Southern African Development Community (SADC) and Free Trade Agreements (FTA) are being utilized to improve access to markets in the EU, US, South America and Asia with an eye toward revitalizing export industries and Foreign Direct Investment (FDI), which hold the key to job creation.

Regarding individual industrial policies, purchases and allocations by large-scale commercial farms as well as farming assistance are continuing with a view toward supporting small farms and nurturing independent operations, which are indispensable to accumulating capital, increasing income and creating employment in rural areas. On the other hand, a variety of regulations and protections are being eased that should hasten the entry of new businesses into the agricultural sector and increase market competitiveness. As for fishery policy, emphasis is continuing to be placed on fostering and assisting cottage businesses, and consideration is also being given to protecting resources. In the manufacturing sector, in addition to the economic policies in the preceding paragraphs, the government and the private sector are cooperating to address assistance with developing technology and human resources, which are vital to improving the competitiveness of industry itself. Additionally, grants are being provided for a variety of preferential measures and infrastructure improvements targeting intra-regional development in order to revitalize and bolster regional industries. Also, there is an emphasis on assisting small- and medium-sized businesses in entering the mining sector, and on allowing public access to national forests in the forestry industry.

1.2.2 FDI Promoting Policies

In September 2000, the Department of Trade and Industry (DTI) announced that the manufacturing support schemes would be replaced with a "six pack" of incentives consisting of the:

- *Small Medium Enterprise Development Program (SMEDP)*, which offers manufacturing and tourism enterprises with "significant expansions of their operations" tax-free cash grants for two years, based on the cost of the investment in land, buildings, machinery, equipment, and vehicles;
- *Skills Support Programme (SSP)*, which offers a maximum of 50% of the training costs, the development of training curriculum and or land and buildings related to training;
- *Critical Infrastructure Facility (CIF)*, which supplements the existing public or private sector infrastructure;
- *Industrial Development Zones (IDZ)* consists of two zones of operation: Customs Secured Area (CSA), and Industries and Services Corridor (ISC);
- *Foreign Investment Grant (FIG)*, which is open to foreign investors located outside SACU and/or the SADC, offering up to 15% of the value of new machinery and equipment;
- *Strategic Investment Projects (SIP)*, which offers a tax allowance of up to 100% on the cost of buildings, plant and machinery, for strategic investments.

In February 2001, an R3 billion incentive package for investors in strategic industrial projects was announced. It entails tax allowances of either 50 or 100% of an approved investment, and is managed through the SIP program of the DTI. In July 2004, the DTI announced a new incentive to attract investment, both foreign and domestic, in the film industry. It established the Film and Television Production Rebate Scheme that allows eligible applicants to receive a rebate of 15% of the production expenditures for foreign productions and up to 25% for qualifying South African productions.

In February 2004, it was announced that foreign companies would be to list on the Johannesburg Stock Exchange and the Bond Exchange of South Africa. This to help local financial markets attract greater market capitalisation, attract foreign direct investment, support the New Partnership for Africa's Development (NEPAD) and support exchange control objectives of enhancing foreign investment diversification through domestic channels.

To encourage investors to establish or relocate industry and business to areas throughout South Africa, the country's various regions (provinces) have development bodies that offer incentives. These incentives, which vary from area to area, include reduced interest rates, reduced rentals for land and buildings, cash grants for relocation of plant and employees, reduced rates for basic facilities, railage and other transport rebates and assistance in the provision of housing. Industrial, technology and agro-tourism strategic development initiatives have been planned in various provinces and include the Maputo Corridor in Mpumalanga, the Gauteng special economic zone and the Wild Coast and Fish River areas in the Eastern Cape.

(1) Spatial Development Initiatives

One of South Africa's key industrial policies remains its commitment to fostering sustainable industrial development in areas where poverty and unemployment are at their highest. This objective is carried out through the *Spatial Development Initiatives (SDI)*, which focuses high-level support in areas where socio-economic conditions require concentrated government assistance and where inherent economic potential exists. The SDI programme consists of 11 local SDIs and four IDZs at varying stages of delivery.

(2) Black Economic Empowerment (BEE)

Black economic empowerment is an integral part of South Africa's transformation process, encouraging the redistribution of wealth and opportunities to previously disadvantaged communities and individuals, including blacks, women and people with disabilities. The empowerment process has been identified as crucial to the future viability of the country's economy.

In March 2003 DTI released a document outlining its strategy for achieving broad based BEE, “The Strategy Document”. Thereafter a broad-based BEE Bill was drawn up followed in August 2003 with a first draft “Code of Good Practice. In January 2004 the *Broad-based Black Economic Empowerment Act 53* of 2003 was signed into law.

Broad-based BEE is defined as:

“the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies that include but are not limited to:

- increasing the number of black people that manage, own and control enterprises and productive assets;
- facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;
- human resource and skills development;
- achieving equitable representation in all occupational categories and levels in the workforce:
- preferential procurement; and
- investment in enterprises that are owned or managed by black people.”

The Minister released three codes in December 2004 with seven more due in 2005. The recently released codes address specific issues pertaining to the *BEE Framework, Equity Ownership, and Management* and include a new generic scorecard with suggested targets for areas such as equity ownership, management, procurement, and equality in employment. The codes are intended to harmonize existing and future industry empowerment charters. Sectors that have completed or are close to finalizing empowerment charters for their respective industries include accounting, agriculture, chemical, cosmetics, clothing and footwear, construction, engineering services, financial services, forestry, health, information and communications technology (ICT), liquid fuels, liquor, marketing, mining, property, tourism, transport, and wine. Each charter is tailored to suit a particular industry, the charters generally stipulate a target of 25% black ownership over the next 10 years

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1.3. Incentives and Impediments for/to FDI

1.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

1) Trade and Investment South Africa (TISA)

South Africa, through its Trade and Investment South Africa (TISA) promotion agency, under the umbrella of the DTI, provides investment facilitation services for inbound investors. While investment opportunities are abundant in many sectors of the economy, the agency concentrates on sectors which research has indicated a high South Africa comparative advantage.

The agency offers the following services to international investors:

- Information on sectors and industries;
- Consultation on regulatory environment;
- Facilitation on investment missions;
- Links to joint venture partners;
- Information on incentive packages;
- Assistance with work permits; and
- Logistical support for relocation.

Trade and Investment Promotion Strategies

A three-pronged investment strategy has been adopted to provide high-level investment performance:

- The development of Industrial Development Zones (IDZs): Duty free processing zones around coastal or inland ports, for dedicated exporters;
- The development of special incentive packages: Development of new and more effective incentives to match those being offered by competitor countries; and
- Policy input for the creation of an investor-friendly environment: Active engagement in the policy debate to improve the overall investment climate.

On the export side TISA's export strategy focuses on secondary or manufacturing industries and the development of SMMEs (Small, medium and micro enterprises).

It also co-ordinates provincial initiatives to match investors' requirements with opportunities available in all nine provinces. In particular, TISA focuses on promoting sectors of the South African economy that show the greatest growth potential and marketability.

These sectors are: chemicals (fine and speciality chemicals, polymers, and pharmaceuticals); minerals and metals (ferrous and non-ferrous metals); agro-processing (meat, fruit and vegetables); textiles (clothing and leather); automotive (materials, technology and research); and information and communication technology (electronics and information technology).

Information Provision

TISA provides information on sectors and industries and information on incentive packages. Internationally, TISA's sales and marketing teams operate from around 50 diplomatic offices and provide core market intelligence as well as identifying opportunities and targeting key investors.

Advisory Service After Set Up

- Assistance with work permits;
- Logistical support for relocation.

(2) Export Processing Zones

South Africa has what it terms "Industrial Development Zones (IDZS)." They are fairly new as the first one was only designated in 2001. The IDZ program and the regulations were introduced in 2000. There are IDZs in Port Elizabeth (Coega) and East London (both in Eastern Cape Province), Richards Bay (in KwaZuluNatal province) and Johannesburg International Airport in Gauteng province.

DTI is currently (June 2005) considering the introduction of investment incentives to boost the investor appeal of the IDZs. South Africa does not have IDZ-specific tax incentives, putting it at a disadvantage to similar competing concepts, which provide lengthy and generous tax holidays. Firms locating within the IDZs do not pay import duties and VAT, but do have to pay corporate tax.

An IDZ is run by an IDZ operator, which can be government-owned, privately owned, or PPP (Public Private Partnership) - structured. Customs control is part of the IDZ operations and handled by the South African Revenue Service (SARS). Licensing of enterprises is part of the process and is performed by the Manufacturing Development Board as the adjudicating authority in collaboration with SARS.

The customs benefits related to manufacturing or processing in the zone are duty-free and VAT-suspension on imports and exports, provided that the finished product is exported. Expedited services and other logistical arrangements can be provided for SME businesses or for new foreign direct investment. Co-funding for infrastructure development is available. There are no exemptions from other laws or regulations, such as environmental and labour laws.

(3) Incentives for FDI

The government has created a number of incentives for potential investors in South Africa. These include, amongst others:

- All business sectors are open to investors;
- No government approval is required;
- To encourage investors to establish or relocate industry and business to areas throughout South Africa, the country's various regions (provinces) have development bodies that offer incentives. These incentives, which vary from area to area, include reduced interest rates, reduced rentals for land and buildings, cash grants for relocation of plant and employees, reduced rates for basic facilities, rail age and other transport rebates and assistance in the provision of housing; and
- The whole process for foreign firms setting up in South Africa from beginning to end on average may take six months, but if done through TISA it can be finalized within one month.

<u>1) Tax Exemptions/Tax Holidays</u>

New rules published by the SARS in June 2005 introduce a withholding tax on the proceeds from the sale of immovable property by non-residents, which must be withheld by the buyer. The tax, which includes the sale of non-residents' holiday homes and shares in a company, excludes primary residences up to R1 million (US$150 850). The tax also does not apply to properties where the total contract price is less than R2 million.

An interest in immovable property includes shares in a company where more than 80% of the net value of the company is attributable to immovable property, and the non-resident must hold a minimum of 20% of the equity share of the company either directly or indirectly.

The act places the onus on the buyer to withhold the tax and pay it over to SARS, but only if the buyer "knows or should reasonably have known" that the seller is a non-resident. The withheld amount must be paid within 14 days from the transaction date. Non-resident buyers will have 28 days to pay over the withheld amounts. Amounts paid in a foreign currency must be transmitted to SARS at the spot rate on the date of payment. The obligation to withhold the tax also applies to estate agents and conveyances, who are entitled to compensation from the sale of the immovable property, and who must give written notification to buyers that the seller is a non-resident.

In 2004 South Africa's corporate tax rate was reduced to 29% from 30%, but it is still far higher than Botswana's and China's 15% levy on foreign firms. Both countries have similar concepts to South Africa's IDZs.

2) Tariffs and Customs

South Africa has done away with most import permits except on used products and products regulated by international treaties. It also remains committed to the simplification and continued reduction of tariffs within the WTO framework and maintains active discussions with that body and its major trading partners. Most goods may be imported into South Africa without restriction, except for certain goods specified by government notice. All second-hand goods, including waste and scrap of whatever nature require an import permit. A number of products are currently subject to export control and licensing. Exporters should apply directly to the government agency that controls the specific permit in question.

A deferment scheme, duty drawback scheme and secure bonded warehouse facilities are available to importers. South African Customs and Excise also administers a programme for manufacturing under rebate, whereby manufacturers may claim a rebate on imported materials used in the production of exports. This facility is exclusively export driven, and to qualify manufacturers must have secure facilities on their premises for the storage of dutiable materials.

(4) Impediments to Attract FDI

The main reasons for the country’s difficulty in attracting FDI are largely related to its low rate of growth, the small market size, distance from the world’s large markets, and the government’s hesitant privatisation programme.

A particularly complicated aspect of the South African environment for a foreign investor, in the institutional and systematic context, is the government’s policies and regulations with regard to BEE. There are specific regulations relating to executive control and ownership which will especially impact on large investors, forcing them to take on board local [black] partners. In addition, certain sectors of the economy are subject to ‘Sector Charters’, which commit the entire sector to meeting certain target percentages of black ownership within a specified time frame. As mentioned earlier, Charters have already been developed for several sectors key sectors, including mining, the petroleum and maritime sectors, tourism and financial services.

In the aspect of social stability and governance, during the last few years, crime has been a far more serious problem than either corruption or political violence and an impediment to, and a cost of, doing business in South Africa. The South African police forces have not been effective or well accepted in many communities because of their historical role in enforcing minority rule, their lack of training, and internal crime and corruption within the forces. There are opinions that high rates of crime, especially violent crime, are a deterrent to attracting U.S. companies to South Africa.

(5) Promotion of Outward FDI

Regional cooperation with the southern African countries, i.e. SADC, is perceived as the fundamental guarantee for South Africa's security, to prevent the threat of inflow of refugees from economically deteriorated neighbouring countries. At the same time, it is recognized that capacity improvement of the SADC countries is necessary to complement and expand the relatively small market size of South Africa to attract FDI from other part of the world. In these contexts, trade and investment by South African private sector play a key role for the economic development of this region.

At the upper policy level, formulation of bilateral economic cooperation /forum is promoted by the President's initiative. At the same time, memorandums of understanding for investment promotion between neighbouring countries including Mozambique, Namibia, DRC and Tanzania are concluded.

1) Export and Investment Promotion by DTI

For export and outward investment promotion, TISA and International Trade and Economic Development (ITED) in DTI offer several assistances under "the Export Marketing & Investment Assistance Scheme (EMIA)". They are:

- Primary Export Market Research;
- National Pavilions;
- Individual Exhibitions;
- Outward Selling Trade Missions;
- Outward Investment Recruit Missions;
- Inward Buying Trade Missions; and
- Sector Specific Assistance.

In the above assistance schemes, DTI provides to the approved companies with financial contribution (airfare, exhibition costs and substantial allowance) and marketing information, organizes missions and arranges for attending exhibitions. Furthermore, it provides "Joint Venture Arrangement" for business matching between South African companies and neighbouring countries' companies, conducts studies through dispatching experts to F/S by the World Bank and IFC, and provides export credit insurance, subsidies for bank loans and undertakings through the Export Credit Insurance Corporation (ECIC). DTI is now considering establishing import incentive scheme for promoting export to South Africa from neighbouring countries.

2) Financial Assistance by IDC and DBSA

Industrial Development Corporation (IDC) and Development Bank of Southern Africa (DBSA), which are the development financial institution of South African Government, play important roles for outward investment promotion. IDC finances various projects outside South Africa, with minimum amount US$5 million per project in SADC countries and US$25 million in other African countries, for both investment and working capital. Its financing strategy needs to be consistent with the Government's strategy to promote investment projects which entail certain share of procurement from South Africa, and every project needs approval of the South African Reserve Bank.

While IDC only finances commercially viable projects even though they are infrastructure development, DBSA primarily finances big infrastructure projects on a long-term concessional loan. As for the financing inside SADC countries, DBSA puts the priority on FDI projects, particularly in agricultural sector, which contribute to development of local economy. Outside SADC, it will only finance the projects contributing South Africa and SADC economy. The total financing amount for SADC countries' projects is limited to one third of the Bank's loan portfolio. It usually finances in the form of syndication loan or co-financing with commercial banks and international financial institutions.

3) Pressure from the Private Sector

The chambers of commerce and industries in SADC countries have organized the Association of Southern African Chambers of Commerce & Industry (ASCCI) since 1999, with the secretariat and presidency rotates among member states, which are presently in South Africa. ASCII holds up i) promotion of Research and Development, ii) dissemination of "new technologies" and iii) economic liberalization in competition, as its common objectives. It is lobbying against member countries' governments to promote institutional development to realize above objectives, in particular development of business related legislations including law on intellectual property rights, trade mark and patent.

According to the Chamber of Commerce and Industry South Africa (CHAMSA), where the ASCCI secretary is located, legislative and institutional development for the enable business environment throughout the SADC region is now recognized as necessary for South African business community to expand their business into SADC market, however, the SADC Secretariat consists of member countries' governments is lacking in the sense of business reality and implementing capacity. Therefore, it is believed that the pressure from the private sector is indispensable to implement various programs of SADC.

1.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

South Africa has an estimated infrastructure backlog of R170.7 billion. In view of the budgetary constraints in South Africa, the government is seeking alternative methods of financing new infrastructure and maintenance of existing infrastructure assets. As a result, there has been increased collaboration between the public and private sectors in order to meet the country's infrastructure requirements.

South Africa's national road network currently covers 7 200km[1], with about 20 000km of primary roads planned in the future. Government projects to maintain new and existing roads, as well as the construction of several new toll road developments, are under way. The semi-privatised Airports Company South Africa Limited (ACSA) manages 90% of the country's aviation requirements. It has transformed a fragmented parastatal into a more service-oriented and market-driven commercial enterprise. The railway network is well developed and operated by mainly Spoornet, a division of Transnet Ltd[2]. Major shipping lanes pass along the South African coastline in the south Atlantic and Indian oceans, through its seven commercial ports[3], which form by far the largest, best equipped and most efficient network on the African continent.

South Africa is largely semi-arid and prone to erratic, unpredictable extremes in the form of droughts and floods. Rivers are the main source of water, but the average annual rainfall countrywide is only 464mm, compared to the world average of 857mm. A variety of new projects are being undertaken to address water shortages[4]. Due to the limited availability of water, the country's main source of power generation is coal. South Africa supplies two-thirds of Africa's electricity. Eskom, a state-owned enterprise is one of the four cheapest electricity producers in the world[5]. South Africa's dwindling coal

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[1] The roads include 1,400km of dual carriageway freeway, 440km of single carriageway freeway and 5,300km of single-carriage main road with unlimited access. Approximately 1,900km are toll roads, serviced by 27 mainline toll plazas.

[2] Spoornet is the largest railroad operator in southern Africa – it has 31,700km of single rail track, 3,500 locomotives and 124,000 wagons.

[3] The National Ports Authority (NPA), a division of Transnet, is the largest port authority in greater southern Africa, controlling seven of the 16 biggest ports in this region. These are Richards Bay, Durban, East London, Port Elizabeth, Mossel Bay, Cape Town and Saldanha.

[4] Examples of the projects are written in the next heading "regional programme.

[5] South Africa supplies two-thirds of Africa's electricity. Eskom is among the top five utilities in the world in terms of size and sales, which has 24 power stations, with a nominal capacity of 40,585 megawatts power. It supplies approximately 95%

reserves mean the country may need more sustainable energy sources by as early as 2008. The energy sector is critical to the South African economy, contributing about 15% of GDP and employing about 250,000 people. The country is currently developing a cost effective nuclear technology called the Pebble Bed Modular Reactor (PBMR), and completion of development is scheduled for 2013. Natural gas could be the alternative source for electricity generation. In July 2004, Sasol opened an 865km natural gas pipeline from Mozambique. South Africa's prospects for natural gas production were also boosted in 2000 with the discovery of offshore reserves close to the Namibian border.

As for telecommunications, South Africa set up the Independent Communication Agency (ICASA) as a regulatory body. Telkom South Africa is a sole provider for fixed lines services[6]. There are three operators for mobile lines, namely Vodacom, MTN and CellC. A joint venture between U.S based Southwest Bell Corp and Mlaysia Telecom acquired 30% stock in 2001. Telekom provides long distance calls or international calls as well. Vodacom (owned by Telekom 50% and British Vodafone 31.5%) and MTN compete in both domestic and foreign market. Cell C (a Saudi Arabia based company) participated in the market in 2001 with the third licence. Customers for three operators amount more than 13 millions and could be 21 millions until 2006.

In October 2004, it was announced that South Africa' is to invest a massive R121 billion in the country's energy and transport infrastructure over the next five years, in what it calls a "major phase of construction" of the economy and a decisive moment for private sector investors, who have been told to take the plans "very seriously indeed".

In his 2005/06 budget speech in February 2005 Finance Minister Trevor Manuel said that significant projects to be undertaken included:

- Investment of some R27 billion in electricity transmission and distribution networks over the next five years;
- Transnet's R4.9 billion locomotive and wagon fleet renewal and modernisation programme;
- Completion of the Port of Ngqura in the Eastern Cape;
- The Berg River Water Scheme in the Western Cape and further development of the Olifants River and Groot Letaba River dam systems in Mpumalanga;
- Recommissioning of the Camden, Komati and Grootvlei power plants in Mpumalanga, and upgrading of the Matimba plant in Limpopo;
- Construction of a hydroelectric pumped storage scheme at Braamhoek on the border between the Free State and Kwazulu-Natal, and two coastal gas turbine plants;
- Building of a demonstration plant by the Pebble Bed Modular Reactor company;
- Upgrading of the coal link line to Richards Bay in KwaZulu-Natal, and of the link between Sishen in the Northern Cape and Saldanha in the Western Cape;
- A new container terminal for Durban and port capacity expansion in Cape Town, Richards Bay and Saldanha; and
- The building of a new multi-purpose Durban-Johannesburg-Pretoria fuel product pipeline.

(2) Regional Programmes

South Africa has been playing the key role for regional networking of economic infrastructures. Roads, Railways and Electric power transmission line etc, has often developed by South African companies with financial assistance from South African public development finance institutions or private banks. As a result, those infrastructures nowadays radiate toward the up north from South Africa. The

of the country's electricity requirements, which equals more than half of the electricity generated on the African continent. Eskom has 26,461 km of transmission lines, which span the entire country and also carry power to neighbouring countries.

6 President Mbeki expressed at the 2005 policy speech further progress of liberalisation on telecommunication sector, giving a licence for second fixed-line operators.

following projects other than spatial development initiatives (SDI)[7] are major ones currently under way to overcome constrains for further growth:

- In April 2002, the Maguga Dam near Piggs Peak in Swaziland was opened as part of the Komati Development Project between South Africa and Swaziland;
- The Lesotho Highlands Water Project undertaken by South Africa and Lesotho saw the completion of Phase 1 in January 1998. The main components of the first phase were the construction of dams at Katse and Muela, an 82 km water-transfer tunnel, and a hydroelectric plant at Muela. The second part of Phase 1 included the construction of the Mohale Dam and tunnel and the Matsoku tunnel and weir, which was opened in October 2001; and
- In July 2004, Sasol opened an 865 km natural gas pipeline from Mozambique to the Mpumalanga plant of synthetic fuels producer Sasol. This pipeline raises the country's use of natural gas as a primary energy source from 1.5% to 4.3% of total demand. The gas imported from the Pande and Temane gas fields in Mozambique through the pipeline will be used by Sasol to substitute some of the coal used at its two plants - at Sasolburg in the Free State and Secunda in Mpumalanga - to make chemicals and diesel and to supply industrial customers in Gauteng.

(3) Trend in Privatisation and Some Observations on Current PPPs

The Department of Finance's infrastructure investment strategy relies on the public corporations, largely financed through private-sector equity or loans, to contribute to infrastructure investment, especially in transport and telecommunications provision. South Africa is well advanced in the Public-Private collaboration for development of infrastructures. Following funds are available.

- The *South Africa Infrastructure Fund (SAIF)* is an unlisted infrastructure fund targeting equity investments in sub-Saharan Africa, especially focusing on private sector investment in Southern Africa. SAIF was established in 1996, whose management was awarded to a joint venture between Macquarie Bank and Old Mutual Asset Managers in South Africa in mid 2000[8]. SAIF has interests in three major toll road concessions[9] in addition to a number of other projects in the rail, airports and telecommunication sectors in southern Africa.
- The *African Infrastructure Investment Fund (AIIF)* is also an unlisted infrastructure fund but AIIF predominantly invests in South African infrastructure projects, including roads, airports, power, telecommunications, rail, ports, water and social infrastructure[10]. AIIF was established in early 2004 as a joint venture between Macquarie Bank and Old Mutual Asset Managers of South Africa. The Fund is a 15 year closed end fund and is closed to new investors as it has reached its intended target size of more than R1,000 million.
- The Private Sector Investments Unit of the DBSA facilitates private sector provision of infrastructure in support of sustainable economic development in the SADC region. The DBSA aims to promote economic development by fostering the growth of productive enterprise and efficient capital markets within the regional and sectoral requirements of DBSA's mandate[11].

Regarding PPPs, a *Strategic Framework for PPPs* was endorsed by Cabinet in December 1999, and in April 2000, Treasury Regulations for PPPs were first issued in terms of the *Public Finance*

[7] Refer to the section 1.2.2

[8] The Fund fully invested its committed capital of approximately R800 million in mid 2003. Investors in SAIF include major South African institutional investors including Standard Bank, Old Mutual, Futuregrowth, Liberty Life Assurance Company, Metropolitan Life, Public Investment Commissioners and Transnet Pension Fund. The African Development Bank is the only non South African investor.

[9] Those are Bakwena Platinum Corridor Concessions, Trans African Concessions and N3 Toll Concessions.

[10] Current investments include Trans African Concessions and N3 Toll Concessions.

[11] DBSA focus on four broad infrastructural groups: basic infrastructure services to the community (eg water and sanitation), economic infrastructure (eg telecommunications, toll roads, rail, power), industrial/agribusiness projects with infrastructure components, and capital market development.

Management Act (Act 1 of 1999). By mid-2000, the PPP Unit was established in National Treasury. The IDC also has the Public Private Partnership Strategic Business Unit which facilitate private sector provision of industrial related infrastructure in support of sustainable economic development. The Strategic Business Unit provides financial and technical assistance, as well as advisory services.

1.3.3 Currency and Monetary Systems

(1) General Conditions

South Africa has a sophisticated financial structure with a large and active stock exchange that ranks 14th in the world in terms of total market capitalization. The SARB performs all central banking functions. SARB was established in 1921. Its independence from the Government is guaranteed by the Constitution in terms of policy operation. All of its 2 million shares are held by private sector. Its shares were once listed in Johannesburg Stock Exchange, but they were delisted in May 2002.

SARB is independent and operates in much the same way as western central banks, influencing interest rates and controlling liquidity through its interest rates on funds provided to private sector banks. Quantitative credit controls and administrative control of deposit and lending rates have largely disappeared.

SARB makes efforts specifically to stabilize prices in order to maintain currency values, introducing the inflation target of 3 to 6 % p.a. in 2000 for that purpose.

SARB does not control money supply as it has adopted the inflation target. Growth of M3 was well controlled from 1999 to 2000, but it increased to some extent in 2001 and 2002. Recently it is higher than the nominal GDP growth rate, but as the demand for currency is caused not by consumption demand, but by investment demand, there is no fear of inflation factor.

As for interest trend, policy interest rate (target level of interest rate for overnight deal) was kept at a level of 10-20% since the second half of 1980's. But as the exchange rate firmed up and growth of consumers' price index was lower, it was cut by 5.5% in 5 times down to 8%. It is now at a very low level in South African monetary history.

In short-term capital market there is a complete set of financial products: BA's (bankers acceptance, generally within 90 days of maturity) which are less liquid in recent years; TB's (short-term treasury bills, generally 3 and 6 months of maturity) which are sold by auction every week; and CP's (unsecured commercial papers).

(2) Banking Sector

South Africa's banks comply with international banking standards and offer one of the most sophisticated banking systems in the developing world. South Africa's political transformation, together with the relaxation of exchange controls and the greater liberalization of African economies, has meant that South Africa is now well positioned to provide global services through its own banks' foreign offices as well as the increasing presence of foreign bank representatives in South Africa.

After a fairly turbulent first half year of 2002, which saw the demise of a number of small and medium-sized banks, stability returned to the sector. South African banks remained well capitalized.

Concentration in the South African banking sector increased noticeably during 2002, and the four biggest banks now represent about 80 per cent of the total banking sector. Oversight of South Africa's banks is the purview of the SARB. The *Bank Act of 1990* regulates private banks. The SARB is nearing completion of meeting all recommendations of the Basel Committee on Banking Supervision. A variety of credit instruments are available to the private sector, including bankers' acceptances, fixed and variable rate securities, bonds, and equities.

In May 1995, amendments to the Banks Act permitted foreign banks to conduct banking operations via branches, ending the earlier requirement that they establish subsidiaries.

Any person, whether South African or a foreigner, may control a bank. There are three alternatives for conducting banking operations in South Africa (all of which require prior approval of the Registrar of Banks, who heads up the Bank Supervision Division): a separate banking company, a branch of an international bank or banking group, and a representative office of an international bank. The criteria for the registration of a bank are the same for domestic and foreign investors. Foreign banks, however, are required to include additional information with their application, such as: foreign bank holding company resolution approving proposed formation of the bank, a letter of "comfort and understanding" from the foreign bank holding company, and a letter of no objection from the foreign bank's home regulatory authority.

The Financial Services Board (FSB) governs South Africa’s sophisticated non-bank financial services industry. The FSB regulates insurance, pension funds, unit trusts (i.e., mutual funds), participation bond schemes, portfolio management, and the financial markets.

(3) Financial Institutions

53 organizations are registered as depository institutions, of which 37 are banks (corporations), 14 are mutual banks (mutual corporations) 14 are branches of foreign banks. Four major universal banks (Stanbic, Nedcor, ABSA, FirstRand) have a 81% share in total assets of banking institutions. 5 organizations (4 major universal banks and Investec (investment bank) have a 87% share in the same. As for assets quality, ratio of bad debts to outstanding loans is 2.4% on average, ratio of bad debts to equity capital is as low as 8.5%, equity capital ratio is 12.2%. Generally, banking performance will be thus sound. Sumitomo Bank (presently SMBC) and Tokyo-Mitsubishi Bank established their representative office in April 1996 and in October 1996 as Japanese banks, respectively.

There are governmental specialized financial institutions: IDC, DBSA, Small Business Development Corporation, Land and Agricultural Bank of South Africa and Public Investment Commissioner (PIC).

Among these institutions, IDC is playing an important role to finance the big ticket commercially viable mainly long-term projects. Main targeted sectors are: agriculture; food processing; mining; oil and gas; ICT; and infrastructure. The period of loan are ranging from 2years up to 20-30years with the interest rate 2-3% above the cost of fund. Currency of the loan varies from Rand to US dollar, British pound, Euro and Yen. They are actively participating in the finance scheme of PPPs. IDC’s financing outside of South Africa is limited to the projects that are in line with the South Africa’s government policies. The projects beneficial to SA’s enterprises are given more priority recently. (refer to Box 1 for details)

DBSA’s financing is directed to public service type of projects such as electricity, water, sanitation and waste treatment. They prefer the syndication loan including PPP scheme. Financing outside of South Africa is limited up to one third of their loan portfolio. Both IDC and DBSA are expecting an active participation from Japan’s financial institutions such as JBIC and even from commercial banks.

(4) Restrictions on Financing

Local Borrowings are restricted - the maximum is determined in terms of a formula and is linked to the amount of owners' funds (share capital, loans and accumulated profits).

In the case of a wholly-owned subsidiary of a foreign company, the maximum local borrowing allowed is an amount equal to 50% of owners' funds. As local participation in the company increases, so does the permissible ratio of borrowings to owners' funds. The limits may be temporarily increased in certain circumstances.

A South African company in respect of which 75% or more of its capital, assets or earnings may be paid to the benefit of a non-resident of South Africa, or of which 75% or more of its voting power, power of control, capital assets or earnings are vested in or controlled by or on behalf of a non-resident of South Africa, is restricted in the amount that it may borrow from South African lenders, and is known as an "affected company".

Local borrowing for these purposes is widely defined and includes virtually all forms of borrowing and financing facilities, e.g. bank loans, overdrafts, facilities and finance leases, but does not include normal trade credit extended by suppliers of goods or services. The borrowing limit is based on a pre-set formula. For companies 100% foreign owned, the local borrowing limit is 100% of the effective capital of the South African company. Effective capital includes share capital, share premium, retained earnings, shareholders' loans to the extent that these are in proportion to shareholding, deferred tax and the minimum trade credit granted to the local company by its overseas affiliates, to the extent it can be viewed as a permanent intra-group facility.

The percentage of effective capital that may be borrowed is (100% + (% local participation divided by % foreign participation x 100)). Affected companies applying for local finance must complete the MP79 (a) form, which discloses the assets and liabilities of the applicant company prior to the granting of the financial assistance. On application, the assets and liabilities of a number of South African companies under common control can be aggregated for the purposes of establishing the maximum level of local borrowings that may be granted to the group, such that an individual company may be "over borrowed", provided that the group as a whole is in aggregate within the borrowing limit for the group.

The Reserve Bank will not permit the remittance of profits or repayment of loans where, as a result of the remittance, the local borrowing limit will be exceeded and will require local borrowings to be reduced before remittance.

Four major insurers, i.e. Old Mutual, Sanlam, Momentum and Liberty Group have a more than 60% share in the market. As of 2003, 75 long-term insurers and 96 short-term insurers were active. More than 45% of assets of the former are managed in equities. It corresponds to more than 20% of JSE market capitalization

(5) Johannesburg Stock Exchange and Bond Market

As for stock exchange, the membership-operated Johannesburg Stock Exchange (JSE) was established in 1887 as a status of “mutual society”. In July 2005, the status has just changed to the “unlisted private corporate”. The stock market is relatively large, and JSE’s market capitalization as was about R1 165 billion (US$180 billion) as of July, 2005, ranked 14th in the world. The number of listed companies as of same date was 472. By industry, natural resources related issues are predominant and have around 40% share in market capitalization, followed by finance related issues which have around 25% share.

On the other hand, as there are many issuers who list their shares in such other marketplace as London, the transaction volume is little and the liquidity is low.

On South African Futures Exchange (SAFEX, an inner-JSE organization acquired by JSE in 2001), various futures and futures options of short-term or long-term interest rate and gold are traded, in addition to JSE major stock price indices.

The JSE includes AltX, an exchange for small and medium-sized companies launched in October 2003. AltX has ten companies with a market capitalization of approximately R1 billon. Early in 2005, JSE launched YieldX, a trading platform for interest rate products.

Bond Exchange of South Africa (BESA) was established in 1989. All major bonds are listed in BESA. According to EIU report, as of March 2003, 272 issues were listed and issued by 43 issuers. Market capitalization as of May 2004 of listed bonds was R 506 billion, of which 74% were government-issued bonds. Their liquidity is relatively high, and the trading volume in 2002 was 27 times as high as the market capitalization. The bond exchange consists principally of government bonds with some bonds from government parastatals also available. There is a growing corporate bond sector, however, as more companies seek to raise capital through this mechanism

In SADC region, there are 10 stock exchange markets. These are in South Africa, Tanzania, Zambia, Mozambique, Malawi, Zimbabwe, Namibia, Botswana and Mauritius. JSE is playing the pivotal to develop the markets and to make concerted efforts such as to unify the listing rules and to set up the integrated systems for settlements.

(6) Foreign Exchange

Significant progress has been made in the liberalization of exchange controls since 1994. The financial Rand mechanism was abolished in 1995, removing most controls on non-residents. In June 1997, controls on South African residents were considerably relaxed, and virtually all controls on current account transactions were removed.

Exchange control in South Africa is administered by the SARB Exchange Control Department and through commercial banks that have been designated as "authorized dealers" in foreign exchange. All international commercial transactions must be accounted for through authorized foreign exchange dealers.

There is no difficulty in obtaining foreign exchange. The financial sector in South Africa is well developed and there are only limited delays in the conversion and transfer of funds.

There are no restrictions on foreign firms wishing to invest in share capital. Investors are advised to ensure that the share certificates are endorsed "non-resident" by an authorized dealer in order to return disposal proceeds and dividends to their country of origin. A record of funds introduced into South Africa should be kept. For every purchase of exchange, irrespective of the amount involved, authorized dealers are required to report to the SARB details of payments received from foreign partners by South African residents.

Royalties, license and patent fees to non-residents, where no local manufacturing is involved, require the approval of the SARB. Manufacturing royalties (as opposed to sales/marketing royalties) are subject to approval by the DTI, which will communicate its decision to the licensee or the Exchange Control Department where applicable, which will enable an approach to a bank directly to transfer the royalty payments. Authorized dealers on production of an invoice may pay current account payments, such as management fees and other fees for services provided, provided that such payments are not calculated as a percentage of sales, profits, purchases or income.

On February 26, 2003 the Minister of Finance announced further measures to relax exchange controls. The changes included the increase of the allowance governing South African corporations' use of South African funds to finance new approved direct investment in foreign countries as well as the unwinding of blocked assets. It was also announced that dividends repatriated from foreign subsidiaries will in future be eligible for an exchange control credit, which will allow them to be re-exported for approved foreign direct investments. Furthermore, the tax payable on foreign dividends was also removed in instances where a South African taxpayer has a meaningful interest in the foreign subsidiary paying the dividend. New emigrants wishing to exit more than the permitted R750 000 from South Africa will in future be allowed to apply to the Exchange Control Department of the SARB to do so, subject to an exiting schedule and an exit charge of 10% of the amount.

In October 2004, the Finance Minister announced in his *Medium Term Budget Policy Statement* (MTBPS) the relaxation of exchange rate controls for corporations. The rules had limited offshore investments to R2 billion per project for investments in Africa and R1 billion elsewhere, in addition to 20 percent of the excess cost. With the new announcement, the limits on outward investments by local corporations and restrictions on the repatriation for foreign dividends are removed as well as restrictions on individuals to invest in foreign firms listed on the South African exchanges. Even though there are no restrictions on corporations' foreign direct investment, corporations will still be required to apply to the Reserve Bank for approval. Limits on pension funds, insurance companies, mutual funds (unit trusts) and individuals are still in place but expectations are that they will be removed soon. More relaxed exchange controls facing corporations should help the government's goal of investment reaching 25% of GDP by 2014.

BOX 1:Government Financing Schemes (IDC)

The state-owned Industrial Development Corporation promotes investment by funding viable projects with development impact. It operates throughout South Africa and offers a range of financing services for small, medium and large scale industries, so as to assist businesses in the establishment of manufacturing concerns in South Africa and the Southern African region. The IDC also provides loan financing to the private sector for the development of viable secondary manufacturing in its target sectors and is often prepared to make an equity investment or enter into joint ventures with foreign investors.

The IDC offers specific financing products:

- Bridging Finance: for entrepreneurs who have secured firm contracts - except for construction contracts - with government and/or the private sector and which have short-term financing needs;
- Financing for empowerment: for emerging industrialists/entrepreneurs who wish to acquire a stake in formal business by way of management buy-ins or buy-outs, leveraged buy-outs or strategic equity partnerships;
- Financing for small-and medium-sized mining and beneficiation: is aimed at small-and medium-sized mining and beneficiation activities and jewellery manufacturing activities;
- Financing for the development of the techno-industry: is aimed at entrepreneurs in the IT, telecommunication, electronic and electrical industries wanting to develop or expand their business;
- Financing for the development of agro-industries: for entrepreneurs in the agricultural, food, beverage and marine sectors wanting to expand and develop their businesses;
- Financing for the development of the tourism industry: is aimed at commercial projects in the medium to large sectors of the tourism industry;
- Financing for the expansion of the manufacturing sector: is aimed at entrepreneurs wishing to develop or expand their manufacturing business and create new or additional capacity;
- Wholesale finance: for intermediaries looking for wholesale funding to lend to individual entrepreneurs;
- Financing for the export of capital goods: for manufacturers and providers of exported capital goods or services. The aim is to provide competitive US dollar and rand financing to prospective foreign buyers of equipment;
- Import credit facilities: for local importers of capital or services requiring medium- to long-term import credit facilities;
- Short-term trade finance facilities: for exporters looking for short-term working capital facilities to help them facilitate export orders; and
- Project finance: is aimed at large projects in the Metals, Petro and Chemical, Manufacturing, Agriculture, Minerals and Mining, and Energy market segments.

With adoption of inflation target since 2000 there has been no target for exchange rates and therefore no market intervention. Exchange rates are fluctuating now more widely than in 1996. Rand tends to be appreciated now that South African economy develops solidly and the rand itself is dearer than other major currencies. South Africa, Lesotho, Namibia and Swaziland constitute Common Monetary Area (CMA), where the rand is a sole legal tender except in Swaziland.

1.3.4 Labour and Management

The South African labour market is characterised by an oversupply of unskilled workers and a shortage of skilled ones. High population growth constantly exceeds the growth in employment demands. This is compounded by the consistent loss of jobs in the formal sector, as the country's economy moves away from labour-intensive to capital-intensive operations. The following steps have been taken to improve worker skills in the economy:

- The government's *Skills Support Programme* (SSP) offers a maximum of 50% of the training costs, the development of training curriculum and or land and buildings related to training. This grant is payable for up to three years;
- The *Skills Development Act* obliges employers to contribute an amount equivalent to 1% of their payroll to assigned industry controlled Sectoral Education & Training Authority (SETA). Employers who submit a sensible training plan will be eligible to receive back a percentage of their contributions (65% in 2001, 60% in 2002); and
- A *National Skills fund* has been established and may, in some cases, be accessed to train local people for employment opportunities linked to new investments.

The following four important labour laws have recently been passed: The *Labour Relations Act* (LRA), the *Basic Conditions of Employment Act* (BCEA), the *Employment Equity Ac*t and the *Skills Development Act* .

The LRA, in effect since November 1996, is the main cornerstone. It enshrines both the right of workers to strike and also the right of management to lock out workers and hire replacement labour during a strike. The Act created the Commission on Conciliation, Mediation, and Arbitration (CCMA). The BCEA, implemented in December 1998, establishes a 45-hour workweek and minimum standards for overtime pay, annual leave, notice of termination, and the like. The Employment Equity Act, meanwhile, prohibits unfair employment discrimination and requires large and medium employers to prepare affirmative action plans to ensure that blacks, women, and the disabled are adequately represented in the workforce.

As a result of increasing pressure from the business community, amendments to the LRA, BCEA and the Insolvency Act have been proposed to counteract the perception that South Africa has an inflexible labour market and to create a more enabling environment for the creation of jobs. These were passed by Parliament in March 2002. In its 2002 Article IV Staff Report on South Africa, released on 23 January 2003, the IMF noted that conditions in the labour market had improved with the introduction of legislation to streamline the arbitration process and allow for more flexibility in employment.

Meanwhile, the *Occupational Health and Safety Amendment Act* of 1993 states that an employer must provide and maintain, as far as is reasonably practicable, a working environment that is safe and without risk to the health of his employees.

The BCEA also prohibits the employment of any child under 15 years of age. In addition, a child between the ages of 15 and 18 may not be employed in employment: if it places at risk the child's well-being, education, physical or mental health or spiritual, moral or social development. Trade unions play an important role in South Africa's labour relations but are expected to experience an erosion of membership due to falling employment levels. It is also suggested, although not required, that investors meet with the relevant trade unions to discuss their interests and concerns during the start-up process.

Companies have meanwhile complained about the introduction, through a regulation in early 2003, of a 2% training levy on the salaries of expatriates in order to enter the country under an expedited visa procedure. The levy does not apply to expatriates already resident in the country or to inter-company transfers. Expatriates who enter the country under the normal visa procedure are exempt from the levy, but the normal process is complex and time consuming.

Several foreign companies have also complained that South Africa's immigration legislation and the application of the law made it difficult to get work permits for their foreign employees. In particular, they have indicated unnecessary delays, rejections of applications and limits (quotas) on foreign workers in a given field. The Government therefore during 2001 introduced an *Immigration Bill*. Parliament finally approved the legislation in May 2002. However, critics charge that the Act, intended to assist with the process of bringing more skilled workers into SA, has created uncertainty and confusion.

Unemployment stands at about 30%, a big jump from 26, 4% in February 2000. The increase is blamed on decreased worker numbers in the subsistence and small-scale agricultural sectors and fewer people working in the informal sector. Employment in the formal sector (including commercial agriculture) has, however, remained stable. Economists believe that South Africa's economy needs to grow by at least 5% – 6% a year to absorb job seekers.

The Employment Equity Act requires designated employers to compile and implement an *Employment Equity Plan* aimed at promoting equal opportunities and affirmative action, while eliminating unfair discrimination. Designated employers include those who employ more than 50 people, or have an annual turnover of a certain amount. The Act is intended to redress the employment disadvantages of black people, women and the disabled ("designated groups"). A designated employer is required to implement affirmative action measures for designated groups in order to achieve employment equity. This will be subject to regular reviews. The Act introduced in 2000, impacts directly on workforce recruitment and composition.

Such affirmative action has increased senior black personnel numbers, and these policies have become standard at all larger companies. According to Towards a Ten Year Review, a discussion document reviewing the impact of the government's policies since 1994, the proportion of black people in top management grew from 12% to 13% between 2000 and 2001, while that in senior management grew from 15% to 16%. The proportion of skilled professionals and middle managers grew only 0.2%.

There nevertheless remains a relative scarcity of skilled black candidates in SA, and the resulting demand for qualified black managers and professionals has seen salary packages rising fast and very high job mobility.

South Africa has the fifth highest prevalence of HIV in the world, with 21.5% of the population estimated to be infected. The UNAIDS Global Report, estimated the number of AIDS related deaths in South Africa in 2003 ranged anywhere between 270,000 and 520,000. Given the numbers of people infected and dying, South Africa is regarded as having the most severe HIV epidemic in the world. This epidemic is still seven years away from peaking in terms of the numbers of projected AIDS related deaths.

The South African Government's response to the epidemic is grounded in the *HIV/AIDS and STD Strategic Plan* for the period 2000 – 2005. The purpose of the plan is to provide a broad national framework around four priority areas: prevention; treatment, care and support; research, monitoring and evaluation; human and legal rights. In November 2003, after considerable sustained pressure from advocacy groups, the government adopted the *Operational Plan for Comprehensive HIV and AIDS Treatment and Care*, which included the provision of antiretroviral (ARV) therapy in the public health sector. The Operational Plan commits the government to providing ARV treatment to 1,650,000 people who need it by March 2008.

However, government and donor funding in South Africa is skewed in favour of national mass media programmes and scientific and academic research, with only a limited level of funding being directed at community driven responses to HIV/AIDS. There is a pressing need to scale up community interventions, for this is where the greatest degree of vulnerability exists and where the consequences of the epidemic are being most acutely felt.

1.4. Official Development Assistance (ODA)

1.4.1 Overview of assistance by donors and international organizations

With GNI per capita of US$3,630[12], South Africa is classified as an upper middle income country[13] and its economy is by far the largest in Sub-Saharan Africa. In fact, revenues by ODA now only constitute around 1-2% of the South Africa national budget[14]. Therefore, donors have tended to provide assistance only in specific areas such as combating HIV/AIDS and reducing inequality, rather than on economic growth in general.

The Government of South Africa organized the first donor conference for South Africa in Pretoria in April 1996. However, donor coordination has not gone beyond the occasional "round tables" to discuss their activities related to investment climates. There are around thirty donors active in South Africa. They are predominantly engaged in providing grants and technical assistances in a wide range of sectors including those related to investment climate improvements. Below is an overview of the assistance by major donors. The US has consistently topped the list, followed by the UK.

Table 1.8: Economic Cooperation towards South Africa by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	United States 83.0	United States 84.6	United States 105.9	United States 85.9	United States 89.4
2nd	United Kingdom 54.1	United Kingdom 62.9	United Kingdom 42.6	United Kingdom 41.8	United Kingdom 47.0
3rd	Germany 42.1	Germany 51.1	Germany 41.6	Germany 36.9	Holland 45.6
4th	Holland 42.0	Sweden 40.9	Sweden 32.4	Holland 34.8	Germany 42.4
5th	France 36.7	France 27.8	Holland 24.2	Sweden 26.5	France 25.4
Japan	30.8	14.1	19.8	13.4	4.7
Total	420.7	386.2	353.6	313.3	375.3

Source: Compiled by MOFA Japan from OECD/DAC

Assistance in areas related to improvements in investment climate is limited. Private sector development aid is primarily towards assisting SMEs. For example, Denmark, Portugal, Sweden, Finland, Switzerland and initially Canada have been active in SME capacity building. Sweden has terminated grant assistance towards South Africa in 2004, but has been active in the area of microfinance, capacity building of regulatory bodies and, industrial and business organisations such as Microenterprise Alliance, and in strengthening of BDS. Sweden will shift its strategies to forming partnerships with South Africa through twining (e.g. local government) and through connecting

12 2004, World Bank Atlas method

13 World Bank classification

14 In 2003, the total government revenue is estimated to be 43.173 billion USD (World Bank data) whereas net ODA is estimated to be 625 million USD (OECD/DAC data). This means that the ratio of aid to government revenue was 1.4%.

businesses by the creation of *South Africa Partnership Fund*. (The activities by the US, the UK and Japan are described below in detail.)

1.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

Japan has recognized the role that South Africa plays in the development of the whole region, and ranked it as a priority country in Japan's ODA strategy. The priority areas of assistance towards the country are: 1) corrections of racial and regional inequalities (e.g. health sector including HIV/AIDS, infrastructure associated to basic human needs including water supply, primary and secondary education, human resources development for capacity improvement of local governments); 2) industrial promotion and regional development to create employment (e.g. technological development, micro, small and medium enterprise (SMME) development, tourism industry promotion, rural development for the agricultural community); and 3) assistance to Southern African countries through partnership with South Africa's organizational strengths and technology (e.g. technical assistance to improve the economy of the whole region and assistance in challenges that run across the region including HIV/AIDS).

Below is a summary of the level of recent ODA from Japan to South Africa. Water supply and education were the main areas of assistance in the form of grants. Especially in the education sector, 32 primary and secondary schools were constructed or improved. Through technical assistance, Mpumalanga Secondary Science Initiative (MSSI) project was implemented, in addition to dispatching Japanese experts in the field of industries and, science and technology. In addition, Japan received trainees in agriculture, education and government sectors. There were no new government loans in 2003. However, there are three outstanding yen-loan-financed projects. Namely, these are KwaNdebele Water Supply Project (¥3,097 million, 1996), Regional Social Infrastructure Development Project (¥4,734 million, 1996) and Urban Rail Passenger Transport Modernization Project (¥6,230 million, 1998)[15].

Table 1.9: Recent ODA to South Africa

(million USD)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-	3.81	9.58	13.39
2002	-20.05	16.38	8.36	4.69
2003	-1.44	11.11	7.94	17.61
Cumulative Total	13.39	69.80	64.76	147.94

Source: Compiled by MOFA from OECD/DAC

Japan has increasingly viewed South Africa as an important partner in solving international affairs. Since 1998, Japan-South Africa Partnership Forum has been held every year to discuss political, economic, cultural, scientific and technological, and global issues. The next forum (8th) is scheduled in Johannesburg in late 2005.

Assistance in areas specifically relating to investment climate in South Africa is a relatively new concern/interest for Japan. Japan has been conducting development studies which will form the basic study to assess the types of future technical assistance projects specifically in SME promotion which are suitable for South Africa. JICA has specified KwaZulu-Natal as the focal region for its assistance and has been dispatching Japanese experts to the KwaZulu-Natal government as a SME promotion adviser. The first adviser was a former Japanese official from the Ministry of Industry and Trade. First, between 2001 and 2002, an analysis of the present situation surrounding machine industries including the automotive industry and its local supporting industries in KwaZulu-Natal was conducted. A promotion plan that included an action plan was presented and adopted by the local government.

[15] JBIC home page

Second, in 2004, a feasibility study of the commercialization of the aromatic oil (produced in KwaZulu-Natal) was conducted. Thirdly, in early 2005, a needs assessment study on the SME promotion assistance and on the business environment was conducted in South Africa in addition to other African members in collaboration with UNDP. In addition, as social welfare assistance, a small business assistance project (2000-2001) and entrepreneur assistance plan (2000-2003) has been conducted in the past.

In the near future, assistance in the private sector is likely to remain in the KwaZulu-Natal region, because it is a poverty-driven region with high unemployment but with an industrial port (Durban) and a sizable industrial area. Technical training of supportive industries for the automotive industries and the strengthening of the institutional framework for SME promotion are possible measures of assistance in the region.

(2) United States

Since the abolition of apartheid and democratic elections in 1994, the US and South Africa have enjoyed good bilateral cooperation especially in areas of counter-terrorism and fighting HIV/AIDS.

USAID has specified the following six developmental goals for the country: 1) supporting the consolidation of South Africa's democracy; 2) increasing access to quality education and training; 3) increasing use of primary health services and HIV/AIDS prevention/mitigation practices; 4) improved capacity to formulate, evaluate and implement economic policy; 5) increasing market-driven employment; and 6) increasing access to shelter and supporting environmentally sound municipal services. Its resource distribution is heavily weighed towards HIV/AIDS area with a budget allocation of approximately US$60-70 million. The next largest budget are to the education and private sector development areas both receiving approximately US$9 million each, followed by democracy (approximately US$7.8 million) and assistance in local governments[16].

The economic growth team in South Africa deals with the private sector development area. SME development, especially in microfinance and in capacity building in market access for agricultural sector forms the bulk of its operations. In particular, currently there are four mains pillars of its operations. First, the South African International Business Linkages (SAIBL) Programme supported by the Corporate Council on Africa is working to enhance trade between the two countries through linking up South African SMEs to American companies. It complements the AGOA initiatives and provides technical assistance in marketing and in meeting ISO standards especially in agro-processing. Second, USAID is assisting microenterprises, for example, through Entengua Links and World Education Grant. Third, USAID conducts capacity building of organisations and business associations. Fourth, the Development Credit Authority (DCA) was set up in 1999 to provide partial credit guarantees for private-sector investment in local development activities to reduce the risk associated with lending to new sectors or new borrowers. In South Africa, DCA guaranteed Futuregrowth Asset Management a 5-year loan of US$ 8.3 million to Capitec Bank. Amongst these four pillars, the SAIBL programme attracts US$ 6.3 million of the total US$ 9 million allocated to this area. US$ 2.3 million is allocated in policy assistance measures[17].

(3) United Kingdom

DFID Southern Africa, based in Pretoria is responsible for DFID's work in Botswana, Lesotho, Namibia, South Africa and Swaziland. Amongst these countries, DFID has a special focus on Lesotho as the poorest country in the region. Within South Africa, it has a particular emphasis on Eastern Cape and Limpopo Provinces, due to the high numbers of poor people living in these areas. DFID spends GB£40 million (R600 million) per year on its work in these five countries. DFID priorities in these countries are: 1) to develop effective national poverty strategies; 2) to promote growth, jobs and

[16] Based on information from USAID staff in Pretoria.
[17] Ibid.

equity; 3) to strengthen democracy, governance and service delivery; 4) to tackle HIV/AIDS; and 5) to support regional cooperation and integration[18].

In the area of growth, jobs and equity promotion in South Africa, DFID has helped to source international expertise on a range of key issues for the National Treasury and Department of Trade and Industry. DFID is also assisting government and other stakeholders with the restructuring of public enterprises. Improving the climate for business is another key area that DFID is working on. This entails ensuring that legal and regulatory frameworks help business development, encouraging that knowledge and shills are shared, and creating links between businesses.

There is also an Imfundo research programme in South Africa, which creates partnerships to deliver ICT-based activities supporting gender equality and universal primary education. Its main involvement in South Africa is to coordinate the Knowledge and Information components of Education Sector Support Programme in the Limpopo Province (Khanyisa).

(4) World Bank

From 1953 to 1966, South Africa took out eleven loans from the World Bank (four for electricity projects and seven for transportation). The last loan was closed in 1968 and all amounts have been fully repaid. Current support is mainly in the form of technical assistance. It is financing one project, Municipal Financial Management Technical Assistance Project, and six Global Environment Facility (GEF)[19] projects are under implementation.

The World Bank is working closely with the South African Cities Network in partnership with the South African Local Government Association (SALGA) to promote pro-poor city development strategies. In addition, the World Bank is about to initiate discussion on a new, participatory Country Partnership Strategy (CPS), focusing on growth and jobs, service delivery, and poverty reduction.

As regards to the IFC's activities, South Africa's portfolio has increased steadily to US$162.6 million[20], and is the second largest country portfolio in Africa after Nigeria. Africa headquarters for IFC is based in Johannesburg.

[18] British High Commission for South Africa homepage
[19] GEF, established in 1991, helps developing countries fund projects and programs that protect the global environment. GEF grants support projects related to biodiversity, climate change, international waters, land degradation, the ozone layer, and persistent organic pollutants.
[20] World Bank, June 2005

2. ZAMBIA

2.1. Trends of Macro Economy, Industry, Trade and Industry

2.1.1 Macro Economy

The IMF announced on April 8th that it had completed its second review of Zambia's progress under the PRGF. The broadly successful review meant that the IMF was able to release a further US$8.3 million, bringing the total amount drawn under the agreement to US$256.7 million. The IMF report on the second review, published later in April, stated that the Zambian economy had outperformed expectations in 2004, with real GDP growth reaching 5%. The impressive macroeconomic performance was strongly aided by fiscal adjustments, which saw the fiscal deficit narrow to 1.7% of GDP in 2004, from 6.6% of GDP in 2003. This meant that the government had to borrow less - domestic borrowing declined from 5.1% of GDP in 2003 to 0.8% of GDP in 2004 - therefore easing interest rate and inflation pressures. Zambia's external position strengthened, with large increases in export revenues. The kwacha remained stable against the US dollar and other major international currencies, but appreciated in real terms by about 8% during the year.

Despite the largely positive IMF review, it does not alter the fact that there is still much to be done by the Zambian government to ensure stable progress in forthcoming years. The government will need to continue with policies to promote fiscal consolidation, which is an essential path for reducing domestic debt and also lowering interest rates and inflation. Reduced domestic borrowing should then free financial resources that the private sector could make use of, providing a further boost to economic activity.

There are still a number of threats to macroeconomic stability in Zambia outside of the government's control:

(1) A fall in international copper prices would seriously affect Zambia's heavily copper-dependent economy. Amongst other things, the current account would rapidly deteriorate, the stability of the kwacha would be threatened and investments in the sector would drop;

(2) Sharp further increases in global oil prices are a major threat to Zambia's economic growth because of its dependence on oil imports for copper mining. Price increases would see imports jump and would also affect inflation;

(3) An unsustainable domestic debt stock of around $1 billion will affect the ability of the government to finance its fiscal deficits and will help keep interest rates high; and

(4) If donor support falls short of targeted amounts, or is simply delivered later than it is needed, then the government's reform plans could be seriously undermined.

Efforts to reduce poverty would almost certainly suffer. The Zambian finance minister, Peter Magande, announced in April that the government had prepared a reform programme aimed at stimulating private sector led economic growth. The government plans to create a pool of resources where local investors would receive loans to invest in the production of goods, and to this end, the Zambia Development Agency (ZDA) has been created to facilitate the loans and provide other relevant services to investors.

The diversification of Zambia's economy is an extremely important issue and, with copper prices high at present, now is the time to embark upon it whilst the cash is available to fund it. Encouraging the private sector to lead this diversification is also a sensible policy, but there are concerns that the government's new reform programme will not deliver the results it desires. Potential areas of diversification are agriculture (e.g. coffee and tobacco), tourism, healthcare and education, electricity and infrastructure sectors[21].

According to the latest information from the IMF, improved fiscal discipline in 2004 led to a reduction

[21] These are areas that have been identified through interviews conducted in Zambia by the Study Team.

in the budget deficit to 1.7% of GDP. In 2005 ongoing reforms of public finance management and accountability will create further savings by improving the quality and coherence of spending plans. However, the government will still struggle to control spending, particularly as it seeks to re-orientate expenditure towards pro-poor activities such as education and healthcare. Also, the 2005 budget has been drawn up with the 2006 elections firmly in mind, and includes large expenditure increases and tax cuts. Nonetheless, owing to the boost given to fiscal revenue by a full year of donor support and continued strong real GDP growth, only a modest increase in the fiscal deficit, to 2.8% of GDP, compared with the Fund's target of 2.5% of GDP is expected.

Monetary policy is expected to focus on reducing inflation to 10%, from the current rate of around 20%, by the end of 2006 by slowing growth in reserve money through the use of open-market operations. However, a significant tightening of fiscal policy and lower domestic debt issuance is required for inflation to hit this level, and given that this is unlikely in 2006, one should not expect this target to be achieved during the forecast period.

Table 2.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	3.7	5.0	6.8	9.0	9.5	9.7	9.9	10.1	10.2	10.4
Population ages 0-14 (% of total)	45.7	47.3	49.4	47.0	46.0	45.7	46.3	46.5	46.7	46.8
Population ages 15-64 (% of total)	51.9	50.2	48.1	50.6	51.8	52.2	51.0	50.8	50.6	50.5
Population ages 65 and above (% of total)	2.4	2.5	2.4	2.4	2.2	2.2	2.7	2.7	2.7	2.7
GDP (constant million 2000 US$)	2,041.8	2,665.9	2,887.7	3,045.3	3,057.9	3,125.9	3,237.7	3,396.2	3,508.4	3,687.3
GDP growth (annual %)	3.9	1.5	1.1	0.8	-1.9	2.2	3.6	4.9	3.3	5.1
GDP per capita (constant 2000 US$)	552.5	540.3	425.5	340.6	322.3	322.7	327.5	337.2	342.5	354.5
Official exchange rate (LCU per US$, period average)	0.7	0.7	7.8	1,210.6	1,862.1	2,388.0	3,110.8	3,610.9	4,398.6	4,733.3
Inflation, consumer prices (annual %)	-	-	76.9	68.1	24.5	26.8	26.0	21.4	22.2	-
Money and quasi money (M2) as % of GDP	18.2	27.7	26.8	13.7	16.3	16.7	19.0	19.8	19.6	19.2
Real interest rate (%)	-	0.8	-15.5	-1.9	10.3	15.8	6.7	17.6	21.1	17.1
Foreign direct investment, net inflows (% of GDP)	-16.6	1.2	2.1	4.0	6.1	5.2	3.8	2.0	2.2	2.3
Foreign direct investment, net inflows (% of gross capital formation)	-58.8	4.4	15.6	26.8	37.3	29.6	20.1	9.8	9.7	8.8
Agriculture, value added (% of GDP)	13.2	15.0	16.5	21.3	21.1	24.2	22.3	22.1	22.2	22.8
Industry, value added (% of GDP)	61.3	48.5	46.4	36.6	29.2	24.8	25.3	25.6	26.1	27.0
Manufacturing, value added (% of GDP)	9.3	16.9	26.9	18.7	13.0	12.1	11.4	11.1	11.6	12.0
Services, etc., value added (% of GDP)	25.6	36.5	37.1	42.1	49.7	51.0	52.4	52.3	51.7	50.2
General government final consumption expenditure (% of GDP)	14.3	23.6	22.4	16.8	15.8	12.9	9.5	12.8	13.0	14.6
Household final consumption expenditure, etc. (% of GDP)	45.6	45.7	63.8	77.0	80.3	88.2	82.2	69.9	69.4	66.6
Final consumption expenditure (% of GDP)	59.9	69.4	86.2	93.8	96.1	101.1	91.7	82.7	82.3	81.3
Gross capital formation (% of GDP)	25.0	29.7	15.5	14.2	16.4	17.6	18.7	20.0	23.0	26.1
Exports of goods and services (% of GDP)	53.5	42.5	33.8	30.8	26.7	22.4	21.1	26.9	23.7	20.6
Imports of goods and services (% of GDP)	38.4	41.6	35.6	38.8	39.2	41.1	31.4	29.7	29.0	28.0
Gross domestic savings (% of GDP)	40.1	30.6	13.8	6.2	3.9	-1.1	8.3	17.3	17.7	18.7
Gross capital formation (% of GDP)	25.0	29.7	15.5	14.2	16.4	17.6	18.7	20.0	23.0	26.1
Food exports (% of merchandise exports)	1.7	1.2	-	6.2	7.1	8.0	10.3	9.6	9.5	-
Food imports (% of merchandise imports)	9.8	9.2	-	9.7	11.8	10.0	7.3	7.7	13.9	-
Agricultural raw materials exports (% of merchandise exports)	0.2	0.1	-	3.9	6.4	10.0	3.6	2.7	2.9	-
Agricultural raw materials imports (% of merchandise imports)	1.1	1.1	-	2.6	3.5	3.2	2.4	1.8	1.6	-
Ores and metals exports (% of merchandise exports)	97.9	97.7	-	75.4	70.4	63.7	62.3	73.5	71.6	-
Ores and metals imports (% of merchandise imports)	0.9	1.2	-	2.2	2.0	0.8	2.5	1.5	1.6	-
Fuel exports (% of merchandise exports)	0.0	0.5	-	1.9	1.5	1.0	1.6	1.2	1.8	-
Fuel imports (% of merchandise imports)	9.5	12.9	-	12.3	9.7	8.5	17.9	8.9	7.1	-
Manufactures exports (% of merchandise exports)	0.2	0.6	-	12.2	13.7	16.8	21.3	12.7	13.6	-
Manufactures imports (% of merchandise imports)	78.1	75.2	-	72.9	73.0	76.9	69.2	79.7	75.1	-
Aid per capita (current US$)	5.1	22.4	51.2	96.5	36.8	64.4	80.4	34.7	62.5	53.8
Total debt service (% of exports of goods and services)	-	26.2	25.2	24.7	21.0	16.1	20.2	11.3	25.4	27.8
Total reserves in months of imports	-	1.3	1.1	1.2	0.6	0.4	2.0	1.2	3.7	1.4

Source: The World Bank (2005), *World Development Indicators: 2005*

2.1.2 Industry

Since its independence, Zambia has taken advantage of its favourable situation located in the centre of the copper belt, and has maintained over a long time a configuration for acquiring foreign currency and domestic industries of which the mainstay is its state-controlled copper and cobalt ores and semi-processed productions. Elsewhere in areas other than copper production, there has only been limited expansion such as the provision of capital equipment, supplies and services to support the copper industry, or the tendering of necessities for daily life including food. Consequently, since the late 1970s when the global copper market entered a period of stagnation, the nation's economy and industry were also driven into a long sluggish period. The copper industry itself also was not able to withstand the fierce competition from newly emerging producer countries and has had to accept a declining trend. Aiming to break out of this situation, the government, by the end of the 1990s, made attempts to improve productivity and production amounts by opening up the copper producing sector, its core industry, to regional private and foreign capital, and in recent years as well has started to make genuine efforts to promote new industries such as expanding, diversifying and creating more value-added in agriculture production as well effectively utilizing its tourism resources.

Sorting Zambia's industries by GDP (2002), agriculture has remained almost unchanged in the last ten years at 22%. In contrast, mining and manufacturing have declined 25 points to 26% with manufacturing (12%) remarkable for its downturn in production. Declines in mining and manufacturing production have mainly been absorbed by the service industry (52%). Neighbouring Zimbabwe and South Africa have relatively broader basic industries. With the independence of the former in 1980 and the democratization of the latter in 1994, both nations' products flowed into the Zambian market, resulting in the swallowing of the fragile and less competitive domestic manufacturing industry with domestic demand seeming to shift entirely toward imported goods and away from domestically produced products.

Looking at a breakdown of each sector, the agriculture sector's principal products are grains such as maize, wheat and rice, as well as cassava (tapioca), cotton, peanuts and other items with strong elements for overall self sufficiency. Also, due to the less developed irrigation network, production yields are heavily influenced by the amount of rainfall. As only 15% of cultivatable land is being used for farm production, the government is aiming to increase production of cash crops such as wheat, soybeans, cotton, coffee, spices, meat, tobacco, vegetables, flowers and other items. Due to the continued socio-political confusion in neighbouring Zimbabwe, there has been an influx of white farmers, which are expected to contribute to the expansion and diversification of domestic agriculture production as well as improved productivity.

In the mining and manufacturing industries, the mining sector has seen a succession of South African and Asian capital enter the mainstay copper producing sector, and is starting new development of copper deposits, of which the nation boasts of the world's largest reserves, unless it had not been sufficiently made effective use. Since 2000, the production of crude copper has been on track to recovery with the improvement of global markets and entry of foreign investors providing a favourable impetus. In other mining sectors, investments in exploiting gold, precious stones and stone, which still remain undeveloped although expected to yield huge deposits, look promising. In the manufacturing sector, regular consumer goods and petroleum products entirely for the domestic market are being produced. In the future, growth is expected in industries oriented toward raw materials, such as the food, textiles and leather industries' acting in concert with an expansion and diversification of agriculture production; the metal and stone industries' links to the creation of value added for mineral resources as well as other operations; and that these developments will lead to an expansion of exports and import substitution.

In the service industry, now with domestic politics and the security situation relatively stable, hope is being placed in the growth of tourism, of which a great portion is unexploited. While the country has the Victoria Falls and many wildlife preserves, the development of infrastructure, such as transportation networks and lodging facilities, are still at an insufficient stage. Fortunately, the number of tourists who visited Zambia increased from 140 thousand in 1990 to 560 thousand in 2002, and tourism revenue remained at the level of US$120 million, which has still a room to increase.

2.1.3 Trade and Investment

(1) Trade

Although Zambia's trade balance has been deficit due to the large import from South Africa, which supplies mining equipment, chemicals and processed food, total export earnings have been increasing because of increased metal export, especially towards East Asian economies. Metal export earnings benefited mainly from the rise in international copper and cobalt prices, as well as increased volumes. Further export earnings came from increased export of cotton lint, tobacco and copper rods and cables.

Zambia has also embarked on a process of promoting non-traditional export products in sectors such as agriculture, manufacturing, mining and handicrafts. These non-traditional exports have continued to exhibit a satisfactory performance relative to the traditional exports of copper and cobalt.

Table 2.2: Trade tendency and main partners

(US$ million)

			1998	1999	2000	2001	2002
Export			865	701	682	985	1,058
Import			1,268	1,287	1,018	1,358	1,552
Main trading partners							
	Export	United Kingdom	252.16	20.20	191.64	15.30	14.68
		South Africa	93.28	63.22	186.00	47.75	51.82
		Malawi	46.29	60.07	57.05	62.98	68.35
	Import	South Africa	427.13	373.45	625.28	625.13	678.43
		United Kingdom	99.55	89.35	91.10	37.71	31.41
		Zimbabwe	112.63	69.88	69.42	12.29	13.34

Source: World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

According to UNCTAD, Zambia has performed fairly well in attracting FDI, despite being a landlocked least developed country. Part of this performance was due to the activities in mining industry, particularly copper. The peak of its FDI inflows in the last decade was $314 million 1993, followed by a sharp decline in 1994, another three-year growth, then four-year decline before the turnaround in 2002 and 2003. This turnaround was mainly as a result of investments by mobile telephone operators. The sector witnessed quite some growth during 2001 - 2002.

Table 2.3: FDI Inflow

(US$ million)

1998	1999	2000	2001	2002	2003
198.0	162.8	121.7	71.7	82.0	100.0

Source: UNCTAD, FDI On-line.

It is estimated that South Africa[22] and UK have been the traditional investors, and the investments from China and Zimbabwe have been increasing recently. In particular, farmers escaped from Zimbabwe are investing in the agriculture sector and contributing to the domestic production and export increase.

[22] According to the Study Team's interview with the South African High Commissioner in Zambia, the accumulated amount of FDI from South Africa to Zambia is around US$2 billion. There are around 300 South African companies in Zambia. These companies specialise in manufacturing, agriculture and service industries. Examples of a large manufacturing company are Zambia Sugar and Zambia Brewery. Small and medium manufactures tend to focus on steel and copper products, and food processing. Private investments in "green fields" are expected to grow. Zambia also expects more mergers and acquisition in the future.

Table 2.4: Largest affiliates of home-based and foreign TNCs, 2002

(Millions of dollars and number)

Company	Host/home economy	Industry	Sales	Employees
Zambia Consolidated Copper Mines	United Kingdom	Mining and quarrying	…	…
Nampak Zambia	Netherlands	Paper and packaging	2.1	…
Dunavant Zambia	United States	Textiles	…	1,200
Chilanga Cement	United Kingdom	Non-metallic mineral products	…	750
Securicor	United Kingdom	Other business services	…	2,300
Safetech Security Services	United Kingdom	Other business services	…	2,000
Sandvik Tamrock Zambia	Sweden	Trade	…	194
Standard Chartered Bank Zambia	United Kingdom	Financing	154.0	586
Citibank Zambia	United States	Financing	92.0	80
Stanbic Bank Zambia	South Africa	Financing	75.0	257

Source: UNCTAD, FDI in brief: Zambia

2.2. Policy Issues Promoting FDI

2.2.1 Industrial Policies and Development Plans

In 2002, the government announced a new medium-term economic policy, the "*New Deal Policy*," whose main objective is to stabilize the macro-economy through economic liberalization, foster industry in the private sector, and diversify the economy. Donor nations and institutions have also indicated their intention to support this policy. The focal sectors of these initiatives are agriculture, mining, manufacturing (in particular, those operations related to resource processing) and tourism, which are designated as strategic development industries.

The specific approaches include reductions and exemptions from a variety of taxes related to production goods, development of an irrigation network, and expansion of financial systems for the agriculture sector. In the mining sector, there is deregulation of a wide-range of state controls and regulations. In the manufacturing sector, customs duties and energy taxes are being reduced in fields for producing goods. In the tourism sector, there is to be development of infrastructure at major tourist sites and financing system for the support of new businesses. A great many in industrial circles have pointed out the inadequacies and delays in the governments approach.

2.2.2 FDI Promoting Policies

Zambia has a generally positive investment climate, although progress toward an open economy has been intermittent over the last three years. During the 1990s, Zambia opened its doors to foreign investment, reduced government intervention in commercial activities, privatized over 258 enterprises and eliminated many market distortions. The impact of these progressive policies, however, was undermined by persistent fiscal deficits and corruption. This led many Zambians to lose confidence in the efficacy of economic liberalization. These doubts provide partial explanation for the Zambian government's decision in 2002 and 2003 to seek alternatives to privatization of the national railroad and the national electricity and telecommunications utilities. In 2003 and 2004, however, the Zambian government increased dialog with the private sector and placed a new emphasis on attracting investment.

The *Zambian Investment Act of 1993* (amended in 1996), stipulates no distinction in between foreign and domestic investors. The privatization process is open to foreign bidders from the point at which companies are advertised. There are no restrictions on foreign investment in the Lusaka Stock Exchange (LuSE), and foreigners may invest on the stock exchange on comparable terms as Zambians.

Several tax advantages exist for companies that list shares on the LuSE. There are no requirements for local content, equity, financing, employment, or technology transfers. The Investment Act provides incentives for investments in rural enterprises, farming, and non-mineral exports.

The Zambian Investment Act is under review, and some proposed amendments aim to increase regulation of the business community and support Zambian entrepreneurs by restricting the role of foreign investors. These regressive proposals, however, appear to be losing favour, and fears that the investment climate might seriously deteriorate are subsiding.

(1) Development Priorities

According to the Development Bank of Zambia, the sectors endowed with the development priorities are as follows:

- Agriculture: Agriculture is considered the cornerstone of Zambia's economic development. The Bank will aim to support various agricultural activities especially those involving the production of high value exportable crops as a way of enhancing foreign currency earning and those which support locally developed agricultural processing and creates employment opportunities.
- Processing Industry: The Bank will support agro processing, mineral and wood processing industries.
- Manufacturing: The Bank will support manufacturing enterprises promoting employment opportunities and particularly those in which Zambia has comparative advantage in the region in order to enhance Zambia's exports into COMESA and SADC regional markets.
- Tourism: Tourism is potentially the fastest growing sector with the capacity to earn the country foreign exchange and contribute to substantial employment generation. There exists a huge untapped potential in tourism which needs to be supported through additional infrastructure, construction of lodges and motels and production artifacts.
- Transport and Haulage: Zambia is a landlocked country and hence is highly dependant on haulage network for its imports and exports. This sector forms an important element in the development process.
- Fisheries: The country has abundant natural resources in terms of lakes and rivers in which breed reserves of various species of fish and conducive environment for the development of fish farming targeting the local and regional market. Fish processing is an industry which has remained untapped and yet is a source of national income, contributor to food security and generation of employment.
- Infrastructure: The Bank will support infrastructure projects in telecommunications, road and dam construction, irrigation, airports, power stations etc

2.3. Incentives and Impediments for/to FDI

2.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

The Zambian Government actively seeks foreign investment through the Zambian Investment Center (ZIC), intended to be a one-stop resource for international investors interested in Zambia. The ZIC was established under the Investment Act of 1991 as part of the government strategy for economic reform. The Centre is an autonomous institution that promotes both local and foreign direct investment, facilitates the investment process and monitors the implementation of projects. It also issues the formal Investment Certificates that serve as the official recognition of one's investor status in the country.

An investment board screens all proposed investments, and usually makes its decision within thirty days. The reviews appear routine and non-discriminatory, and applicants have the right to appeal investment board decisions.

Application Processes and Systems

The legal requirements for establishing an office in Zambia are relatively simple. A prospective company must register with the Registrar of Companies at the Ministry of Commerce, Trade and Industry by submitting the company charter and a registration fee. This may be done by an individual, a law firm, or by a business consultant. The minimum nominal capital required to register a limited company is currently US$5 000 plus a 2.5% registration fee. After submission of the company charter and payment of registration fees, a Certificate of Incorporation is generally issued within 24 hours.

Foreign companies that plan to invest in Zambia should obtain an investment licence from the ZIC to take advantage of ZIC advocacy and services. The procedure is simple and licences are approved or disapproved within 30 days. Licences generally allow for up to five expatriate managerial/technical staff.

(2) Export Processing Zones

In 2002, the government amended the Customs and Excise Act in order to accommodate the tax free zones, and passed the Export Processing Zones Act to provide incentives for investors in export processing zones. Most regulations related to the EPZ were, however, suspended in 2004 due to the government's perception that these benefits were being misused by investors.

(3) Incentives for FDI

Investors who qualify in one of the five categories below shall be entitled, in addition to the general incentives, to an exemption from customs duties and sales duties on all machinery and equipment (excluding motor vehicles) required for the establishment, rehabilitation, or expansion of that enterprise:

- Exporters of non-traditional products, which result in net foreign exchange earnings;
- Manufacturers of products for local agriculture and the production of agricultural commodities or other agro-related products for export;
- Businesses engaged in tourism resulting in foreign exchange earning in excess of 25% of the gross annual earnings of the business unit;
- Businesses engaged in an import substitution industry using a significant proportion of local raw materials resulting in net foreign exchange savings; and
- Businesses located in a rural area.

There are also investment incentives for particular sectors including mining, manufacturing, and agricultural sectors as follows:

1) Mining sector

- Mineral royalty ranges from 0.6% to 5% of the gross value;
- corporate tax has been reduced from 35% to 25% and the period of carry forward of mining losses has been extended from 10 to 20 years;
- Exemption from payment of customs duty on consumables and mineral royalty up to a cap of US$16 million in the first year, and US$15 million per year for the next 4 years thereafter;
- No payment of withholding tax on interest, dividends, royalties and management fees paid to shareholders and affiliates;
- Copper and cobalt price participation fees are tax deductible;

- No payment of excise duty on electricity consumed;
- The restriction of offsetting losses against profits, which is limited to 20% for mines with a common owner that are not adjacent, has been removed so that 100% of the losses can be offset; and
- Duty-free importation of capital equipment and utility vehicles.

2) Manufacturing sector

- Duty on a number of raw materials has been reduced from 15% to 5%;
- 5-15% duty on some categories of industrial machinery (e.g. industrial furnaces and ovens, printing machinery and machinery used in food production);
- Custom duty rate on selected items used on manufacturing process has been reduced; and
- Excise duty on some goods (tyres and tubes) has been removed completely.

3) Agriculture sector (horticulture and floriculture)

- Duty on agricultural inputs such as bovine semen, animal embryos and fish meat has been removed completely;
- Duty rate on green house plastic sheeting, tubes, pipes and hollow profiles has been reduced from 25% to 15%;
- Duty on the medium used for growing roses has been removed; and
- Duty on cold-room equipment has been reduced from 25% to 5%.

4) Tax Exemptions/Tax Holidays

As noted above, investments in mining, manufacturing, and agriculture (horticulture and floriculture) sectors are provided reduction and/or exemption of taxes and duties. Tax on companies listed on the Lusaka Stock Exchange (LuSE) is 30% (normal corporate tax is 35%).

There are income tax deductions as follows:

- Any loss incurred other than in investment in mining in any charge year shall be deducted only from the income of the investor from the same source as that in which loss was incurred. Such loss shall be deducted from his income in the following year, from year to year.
- Any payments made for the purpose of technical education by a business enterprise, or for the purpose of obtaining further experience, training, or qualification relating to that business enterprise.
- Any expenditure, not being expenditure of a capital nature incurred by a business enterprise during the current year on experiments or research relating to that business enterprise.
- Portion of income which is determined by the Commissioner of Taxes as originating from the export of non-traditional products is taxed at a rate of 15% (traditional exports are all mineral exports of copper, cobalt, lead, zinc, gold, and silver).
- Income received from a rural enterprise for each of the first five years of operation will be exempt from tax.

5) Tariffs and Customs

There are incentives for tariffs and customs as follows:

- Custom duty exemption on most capital machinery and equipment of mining and agriculture;
- Duty-free imports of raw materials such as organic and inorganic chemicals, rubber, steel, and plastics;
- 5% customs duty on other capital machinery and equipment;
- 5% customs duty on other raw materials; and

- 15% customs duty on intermediate goods and 25% customs duty on finished goods.

On October 31, 2000, the Common Market for Eastern and Southern Africa Free Trade Area (COMESA FTA) was launched. Zambia and eight other participating countries in the region are working toward limited currency convertibility among members to reduce transaction costs and to make the region more competitive. In 2001, the Zambia Revenue Authority (ZRA) implemented the zero tariff under COMESA to match tariffs from other member countries. An audit and business risk department is already in place at the customs head office to look at post-clearance of goods. In addition, there is a control unit that consists of officers trained in enforcement and investigations, which monitors transactions in all major border stations. An intensive data monitoring and exchange program with other COMESA members will ensure that the rules of origin are verified.

(4) Impediments to Attract FDI

The Zambian Government has a history of frequent and unpredictable changes to key policies that has had a damaging effect on both foreign and domestic investment. It is said that many firms think that government officials' interpretation of regulations affecting their businesses is inconsistent and unpredictable. For example, the immigration laws were recently changed requiring all non-Zambians to renew unexpired permits at high cost. No clear rationale was given when mining royalties were recently increased by 150%. There are also numerous relatively new agencies within the Government, some of which require licences, not to mention the licences required from relevant industry regulatory bodies. Compliance with these regulatory bodies can be a struggle especially for small and medium enterprises.

Also, according to the US Department of Commerce "corruption is an important obstacle to Zambia's economic development…. Corruption related to privatisation in the 1990s has eroded public confidence in policies meant to liberalize the economy[23]".

For most, Zambia's location is a major disadvantage. Not only is it a land-locked country far away from seaports, but certain neighbouring countries are a negative influence, with war-torn DRC to the North and strife-laden Zimbabwe to the South. In addition, the perception of Zambia's investment climate is largely unfavourable. The Institutional Investor, for instance, placed Zambia's credit worthiness in the bottom quartile for Africa, below that of Nigeria and Cameroon, as well as those of nearby countries such as Mozambique and Uganda. These disadvantages are further compounded by Zambia's relatively small economy. However, this location disadvantage is able to be reversed into advantage, if Zambia could make itself as the "bread basket" for those neighbouring countries by fully utilizing its abundant natural resources, particularly in the agricultural sector.

2.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

Zambia's road network[24] accounts for a large percentage of the transport of goods. Zambia's main arterial roads comprise of the Great North Road, Great East Road Mumbwa Road and Kafue Road, which give the country access to all the neighbouring countries. The national road system has been improved, but due to the over-dependence on road transport of heavy supplies and goods, the roads that are being built are being worn out at an unacceptably high rate.[25] Residents except in the Centre of Lusaka have seen no road improvements. The industrial areas in these towns have such a poor road system that it affects the efficiency of transporting raw materials and finished goods into and out of their facilities. Although the country has the potential to be a net exporter of agricultural commodities

[23] U.S. Department of Commerce, *Country Commercial Guide – Zambia, FY 2004.*
[24] Total length are 38,763km of which approximately 6,000km tarred, 8,500km in gravel and earth roads, and 23,998km unclassified.
[25] The pressure placed on the road system by the transport of heavy goods could potentially be alleviated with better maintenance or more efficient operation of Zambia Railways following its recent concession to a private operator.

to the regional markets, smallholder farmers face major difficulties and costs transporting their produce to the markets even in domestic urban centres. The air transport sub sector is predominantly in the hands of the private sector, in both passenger and cargo categories. Rail transport is the other dominant mode of transportation for goods on the local and international routes. All lines except the unreliable Tazara railway linking Zambia and Tanzania are well connected to the neighbouring countries. Although Zambia is a land-rocked country, there is a port on Lake Tanganyika. The port is in need of extensive upgrading. Zambia formerly had its own ocean-going shipping line, which was dissolved, but there have been calls in recent years to re-establish it in view of potential cost savings.

Zambia has abundant energy resources. Especially, the hydropower resource potential is enormous.[26] The hydropower resource contributes about 14% of total energy use[27]. The woodlands and forest provide over 66% of the nation's total energy needs, and coals satisfy 9%. The country's only major energy import is petroleum. Its vast water resources and coal reserves[28] render electricity relatively inexpensive. However, the power sector is becoming increasingly unreliable. The percentage of production lost due to these outages is very high. Zambia Electricity and Supply Company (ZESCO), a major generator and distributor is under strain to be commercialised for provision of reliable services. The business community feels uncertain about the approach to be taken to improve the quality of service delivery and access to services provided by ZESCO. It matters much less whether the required improvements in service provision come through commercialisation or through privatisation. What is important is that those improvements are delivered as quickly as possible to help put the Zambian economy on a more competitive footing and on a sustainable higher growth plane.

Water issue is not so much a problem in general. Even where surface water is not conveniently available, there are extensive underground water sources, usually at no great depth. Present estimates are that 55% of households in Zambia have access to clean water[29]. Many of the industrial districts in major towns however do not have consistent and adequate water supplies, especially in the Copper belt. Many businesses resort to incurring the extra expense of building wells in order to ensure a constant flow of water.

Postal services are fair. Both normal and express services are available in all main centres. On the other hand, telecommunication services are widely recognised to be improved. Although there are enough number of mobile phone operators[30], perceptions are poor due to the fact that the markets for mobile telephony are functioning more efficiently in some of other neighbours. Even where fixed lines are concerned, there is great room for improvement in Zambia. Poor telecommunications are a hindrance to doing business especially for services sector firms such as tourism.

(2) Regional Programme

The government and a private firm, Northwest Railways Limited, signed an agreement in late April 2005 giving the firm the go ahead to build a new railway line to link Zambia with Angola's port of Lobito.[31] Although the financing for the project is not yet in place[32], if successfully completed, the railway line would be of great benefit to Zambia, as it would cut the distance and time for its exports, especially copper, to reach the seaports in comparison with the South African port of Durban or Dar es Salaam in Tanzania. The new railway line will be constructed in three phases:

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[26] The estimated potential is 6,000 megawatts. But the installed capacity is only 1,715 megawatts.
[27] Generation is mainly from Kariba North Bank (600 megawatts), Victoria Falls (108 megawatts) and Kafue Gorge (900 megawatts). In addition there are six small hydropower stations, namely, Lisiwasi, Chishimba Falls, Musonda Falls, Itezhi-Itezhi, Mulungushi and Lunsemfwa.
[28] Proven coal reserves exceed 30 million tonnes.
[29] While only 35% of rural households have access to safe water.
[30] At present, there are four operators existing for mobile phone. They are Cell Z, Celtel Zambia, Vodacom Zambia and Telecel.
[31] The project envisages a 685-km railway line running northwest from Zambia's mining hub in the Copperbelt province to join Angola's Benguela railway.
[32] According to the Background study, It is said that there was much interest from South African investors.

・ it will initially connect the Copperbelt town of Chingola to Solwezi in the North-Western province;
・ during phase two, the line will be extended to a new mine at Lumwana in the North-Western province; and
・ the final phase will connect the line to Angola's Benguela railway, itself expected to undergo refurbishment.

Other cross country projects include the refurbishment of Mpulungu harbour on Lake Tanganyika which has attracted interest from South African investors as an alternative to the sea route for Eastern and Central African countries. Zambia, the Democratic Republic of Congo, the United Republic of Tanzania and Burundi border the lake.

In electricity production, Zambia with Zimbabwe is a joint owner of Central African Power Corporation (CAPC). The two countries share the costs and output of the Corporation, which exploits the hydro potential of the Kariba North and South power stations.

(3) Trend in Privatisation and Some Observations on Current PPPs

The Zambia Privatisation Agency is an autonomous agency of the Government of the Republic of Zambia, established in 1992 through the *Privatisation Act No.21* (1992). Its function is to plan, implement and control the privatisation of state owned enterprises in Zambia, in cooperation with the government, by selling them off to those who are more competent to run them and who have the required capital to do so.

The method used for offering shares depends on the type of company for sale. For example, smaller companies to be sold as a single entity will go under public tender, while larger complex organisations may be publicly floated. Other options include the Management Buy Out system (MBO), which gives option of sale to management staff who may or may not work with other partners to secure ownership. The establishment of the Privatisation Trust Fund has also opened the doors to ordinary Zambians to own shares and invest in state owned enterprises being privatised through the buying of shares on the stock exchange.

The World Bank's review of Zambia's experience with privatisation found that one of the reasons some privatised companies did not perform to the expected standard is that previously state-owned enterprises were released into a regulatory vacuum or into an inadequate or inappropriate regulatory framework. Such regulatory frameworks include the legal framework, the institutional design of the regulators and the capacity of the regulators to discharge their mandates effectively. It is at all three levels that reforms are needed, especially in the infrastructure sector, to achieve higher and sustainable economic growth. To facilitate the growth of the private sector, a sound and predictable regulatory and policy framework needs to be developed and implemented.

Privatisation or commercialisation programmes planned in infrastructure are following. In transportation, commercialisation of maintenance services of road networks is said under plan with assistance from World Bank. Railways are advanced to some extent. Zambia Railways are already concessioned out for 20 years contract to a joint venture composing of two South African enterprises. It is also said that South African investors are also said to have an interest in Mpulungu harbour on Lake Tanganyika. Regarding electricity supply, the government is encouraging entry of private companies, following the amendment of the legislation.[33] The commercialisation process is underway for ZESCO as well. In term with communications, the sector is opened to the private companies under the regulatory body, Communications Authority of Zambia (CAZ) which is created in 1994.

[33] For instance, the government is promoting the following projects as opportunities for private sector finance: Kafue Gorge Lower Hydroelectric project, Itezhi-Itezhi Hydroelectric project, Zambia-Tanzania Interconnector and Zambia-Namibia Interconnector.

2.3.3 Currency and Monetary Systems

(1) General Conditions

Financial policy focuses on an effort of controlling inflation as low as 10% by the end of 2006. A considerable tight fiscal policy and a restriction on issue of bonds in the domestic market are indispensable for that goal, which is likely to be difficult to attain.

In addition to trying to contain inflation, the main focus of the Bank of Zambia (BoZ, the central bank) is to encourage commercial banks to grant loans to private sector. For that goal it dropped its credit reserve ratio from 17.5% to 14% in October 2003. It is less successful, as the funds intermediating functions of banks themselves are weak. For borrowers the costs of funds are still expensive as they have to bear bank's fee in addition to interest. A fundamental reform, including revision of bankruptcy rules, is necessary in order to promote bank loans.

Inflation rate was 18% in 2004, that in 2005 it may be lower thanks to debt-relief, financial aids provided by donor countries and the tight fiscal policy.

Exchange rate in 2004 was relatively stable thanks to recommencement of donors' aids, increase of export revenue arising out of hike of international copper price, and debt relief among all. High-rate inflation, unsatisfactorily low creditability in Zambian Kwacha, excess demand of foreign currencies over supply are factors likely to contribute to depreciation of the national currency.

(2) Banking Sector

The banking sector is supervised by BoZ which reports to the Ministry of Finance and National Planning. The sector is governed by the *Banking and Financial Services Act of 1994* and accompanying regulations of the Laws of Zambia. BoZ has proposed amendments to this Act to strengthen its supervisory powers and make the Act applicable to non-bank financial institutions. Industry observes generally credit the BoZ with making large strides in improving bank oversight over the past several years. Parliament passed legislation for deposit insurance systems and for controlling money laundering activities.

Despite BoZ's attempts, lending rates have remained high and deposit rates negligible as a result of the low level of financial intermediation. Because of this, commercial banks have invested the funds released by the reduction in the reserve requirement in Treasury bills. More fundamental structural reforms, such as revision to bankruptcy laws, may be necessary to give a real boost to lending. Moreover, even if the spread between lending and deposit rates is lowered substantially, there are many other bank charges that borrowers face, which will keep the cost of borrowing from banks high.
Among foreign banks, Stanbic Bank (100% subsidiary of South Africa's Standard bank) boasts of having the largest loan portfolio. Other foreign banks operating actively in the country are Standard Chartered Bank, Barclays Bank, CITI Bank, Indo Zambia Bank and Bank of China. Majority of their lending is limited to short-term loan including trade financing, as they are rather reluctant to take the long-term risk because of lack of securities. On the other hand, there are some long-term financing cases by the co-financing with European Investment Bank and Development Bank of South Africa.

Issues to be tackled in the banking industry are: lack of credit rating agency and credit bureau (information centre); weakness of commercial codes; and protracted legal procedures. These issues could be addressed in the framework of SADC as they are more or less common issues in the region.

1) Financing Exports and Insurance: The use of credit is the most common method of payment used for Zambian imports. In general, companies find it very difficult to finance their own imports and seek credit arrangements, but businesses considering offering their exports on credit should make a very careful check of the bona fides and finances of Zambian companies before doing so. Delinquent payments to suppliers are a common problem in Zambia.

The Overseas Private Investment Corporation (OPIC), a US government agency offers project financing, political risk insurance, and investor services in Zambia. The US Export-Import Bank currently provides only short-term insurance covering consumables, small capital goods and raw materials up to 360 days.

2)zProject Financing: The availability of project financing, particularly for export-oriented projects, is improving. Besides bilateral and multilateral government agencies, commercial banks and venture capital funds are playing an increasing role. Both the US and EU have established enterprise development funds, which encompass Zambia. The IFC and Commonwealth Development Corporation (CDC) both offer financial assistance for projects in Zambia.

(3) Stock Exchange

Lusaka Stock Exchange Ltd (LuSE) was established in order to promote privatization of state-owned enterprises by the assistance of World Bank and UNDP. The number of listed companies is 13 companies comprising of brewery, sugar, cement, copper mining, investment company, bank, hotel, retailer and etc. Bond exchange is also existent and the combined market volume with the stock exchange is approximately equivalent of US$1.7 billion. According to the information given by LuSE, the number of institutional investors and individual investors is 20 and 40,000 respectively. Lack of market liquidity is to be addressed.

(4) Foreign Exchange Controls

Following a repeal of the *Exchange Control Act* in February 1994, Zambia established full convertibility in both the current and capital accounts. There are no controls on the movement of capital in or out of Zambia. Bank accounts may be held in local or foreign currency, and funds are easily transferred out of the country or held offshore. Amounts over US$5 000, carried in or out in cash or travellers checks, must be declared. In March 1999, the Central Bank BoZ instructed commercial banks and Bureau de Change operators to restrict issuance of over-the-counter cash to US$5 000 per transaction.
In mid-January 2001, as a result of foreign exchange troubles, the Ministry of Finance and National Planning announced the following measures to stabilize the exchange market: a 75% domestic receipt of all export proceeds within 180 days from date of export, all external payments over US$ 5 000 must be channelled through commercial banks, only foreign exchange dealers authorized by the BoZ would be allowed to price foreign currency and receive, buy or sell foreign exchange, authorized foreign exchange dealers were required to limit margins between buying and selling rates for no more than 2%, charge and settle all domestic transactions in Kwacha, except for licensed tourist enterprises authorized by BoZ, a mandatory BoZ auctioning window was introduced, foreign currency sales were limited and bank reserve rates were raised dramatically. These measures severely over-inflated the value of the Kwacha and forced the BoZ to offload approximately US$25 million, almost half of its foreign exchange reserves.
General Availability of Financing: There is a shortage of domestic financing except for export-oriented production. Interest rates rose dramatically in 2000, and continue to increase through 2002, making medium or long-term borrowing unfeasible. Short-term borrowing is available, but expensive. Many businesses either self finance or seek finance outside the country, in hard currency.

2.3.4 Labor and Management

Productivity in firm level is low in Zambia. Adding to the issue of low labour productivity, the lack of flexibility in labour market amplifies the dissatisfaction with regulatory policy. While some labour laws have been amended in recent years, the majority has not substantially changed since the period of the socialist government. This cost acts as a deterrent to increasing staff, even when needed to meet demand.

There is evidence that suggests that with insufficient educational system, technically qualified labourers are hard to find, thereby raising the cost of labour. As technical skills diminish, the quality of the labour diminishes, yet the cost remains high because of a combination of low productivity and Government's policies that create high terminal benefits for employees. For the government, it seems to tough to reform or make more flexible the actual labour policies, taking into account the fact that many employees do not earn enough take home pay to properly feed and educate their families. Finally, it is also worth noting that the high cost of labour in the public sector (including high termination costs) may well have created higher costs to the private sector as well.

Since early 2002, the Government has been implementing a Technical Education, Vocational and Entrepreneurship Training (TEVET) Development Programme (TDP), aimed at improving the quality, sustainability, demand responsiveness, and equity of TEVET in Zambia. But the facilitation was slow. The review team presented some recommendations including a number of steps for implementation. The government is developing an Action Plan in response, but not fully implemented.

There are problems with the acquisition and renewal of employment permits. The business community sees the procedures, particularly for renewal, as lengthy, cumbersome, and unpredictable. There is also a high degree of discretion in the way employment permits and work visas are awarded. These problems are reflected in firms' inability to hire high quality workers in a timely manner.

The minimum wage for non-government and non-unionized[34] workers would be no less than US$22.6 (95,000 kwacha) per month. As same as other countries, the minimum wage does not provide a worker and family with a decent standard of living; most minimum wage earners supplement their incomes through second jobs, subsistence farming, or reliance on the extended family. The legal minimum age for employment is 16 years, and the Labour Commissioner effectively enforced this law in the industrial sector. But in fact, demand on child labour is not so much in the industrial sector as in agriculture, domestic service, and informal sectors.[35] The law enforcement is not implemented in those sectors.

The Constitution recognizes the right of workers to form and belong to trade unions[36], and workers exercised these rights in practice. Legislation governing the rights and obligations of employers and employees is mainly contained in the 1993 *Industrial and Labour Relations Act*[37] which, among other things, contains the principle of employee involvement in certain aspects of the business. The Act also sets out a framework for the role of the trade unions, prescribes the conditions under which strikes may be called, and minimum wages. Although all workers have the legal right to strike except those engaged in essential public services, but registration of unions is somewhat burdensome.[38] In fact, there has not been a legal strike since 1993. The Act confirms the Industrial Relations Court as the final arbiter of disputes.

The most recent data shows that the impact of HIV/AIDS in Zambia is enormous: about 1 million adults and 200,000 children were living with HIV/AIDS by the end of 2001, and nearly 600,000 children have lost their mother or both parents to AIDS. Life expectancy has been reduced from 57 years in 1990 to 37 years in 2001. Estimations of the impact on the economy show that it's costing the country up to 1% in GDP per year. Although firm-level data is not available, it is fair to say that the losses of human resources and national economy caused by HIV/AIDS directly reflect productivity

[34] Although no concrete figure is available, almost all unionized workers receive salaries considerably higher than the non-unionized minimum wage.
[35] Approximately 600,000 children are in the work force. Of which approximately 87% work in the agricultural sector (ERA 2005).
[36] Only 11% of the eligible workforce was employed in the formal sector; approximately 60% of the formal sector was unionized (ERA 2005).
[37] The Industrial and Labour Relations Act as well as the Employment Act are under review in line with the government's liberalization policy. A comprehensive social security programme has been designed, but not yet implemented.
[38] For example, no organization can be registered unless it had at least 100 members, and, with some exceptions, no trade union may be registered if it claimed to represent a class or classes of employees already represented by an existing trade union or eligible for membership in an existing trade union. Unions may be deregistered in certain circumstances.

losses in the private sector. The high prevalence of the disease among Zambia's population is not only depleting the pool of locally available skills, it is also driving up the effective cost of doing business and in particular the cost of employment. As trained people die from AIDS, businesses are forced to train multiple people for key positions, thus increasing their training and recruitment costs. This issue is a source of anxiety in common for the firms in Zambia

2.4. Official Development Assistance (ODA)

2.4.1 Overview of assistance by donors and international organizations

Zambia has pursued policies of economic liberalization and structural reform programs that have transformed the country from being a centrally-planned and controlled economy to one of the more open market economies in Africa. Free universal basic education and access to health services are also emphasized. In addition, the President is running an unprecedented politically driven "zero tolerance for corruption" campaign to get at the roots of corruption in Zambia and is engaging in constitutional reforms to address issues of governance.

Zambia has drafted the PRSP and was approved by the World Bank Board Meeting in 2002. The Transitional National Development Plan (TNDP) 2002-06 was also announced. The PRSP revolves around three main approaches: economic, social and cross-cutting issues. These themes are related to two main approaches to achieve the overall goal of poverty reduction. The first approach is to generate sustained economic growth and employment. Agricultural development is regarded as the main engine of growth, complemented by other sectors including tourism, industry, mining and energy. The second approach provides for complementary measures that directly target the poor by stressing the importance of basic education, basic health and social safety nets such as the Public Welfare Assistance Schemes (PWAS), Social Recovery Fund, Project Urban Self Help (PUSH), Food for Work Programme and entrepreneurial development and training for the retrenched employees. Thirdly, there are also cross-cutting themes – HIV/AIDS, gender and environment, that impact on both the growth and the direct interventionist measures.

Zambia receives assistance from a variety of bilateral and multilateral sources. In Zambia, under the ownership of the government, donor conferences in various areas such healthcare, agriculture, roads and education have been held and aid harmonisation is advanced. Framework documents for aid harmonization in the health and education sector have already been signed. However, some donors, namely, USAID and Japan have not signed the documents. Donors have also been harmonizing the procedures of aid and donors have signed the memorandum "Harmonization in Practice". General budget support and sector-level budget support have been advocated by DFID and EU. Aid climate is increasingly moving away from project assistance towards budget support.

Export-oriented private sector-led development strategy is adopted by the government and supported by donors. This was reconfirmed in the recently published 2005 Diagnostic Trade Integration Study. Donor coordination is expected to strengthen in this area.

Table 2.5: Economic Cooperation towards Zambia by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	Germany 50.0	Germany 64.7	Germany 112.2	United Kingdom 55.8	Japan 68.4
2nd	Japan 33.6	United Kingdom 63.6	United Kingdom 111.4	Japan 47.0	United Kingdom 48.3
3rd	United Kingdom 33.4	Japan 59.4	Holland 51.2	Holland 29.6	Germany 44.2
4th	Norway 31.8	Norway 27.4	United States 46.1	United States 29.0	Holland 35.5
5th	Holland 22.5	United States 26.6	Japan 31.9	Denmark 22.6	Denmark 32.2

Japan	33.6	59.4	31.9	47.0	68.4
Total	256.5	340.0	486.2	274.1	359.5

Source: Compiled by MOFA Japan from OECD/DAC

2.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

Japan's strategy towards assistance towards Zambia is to continue to emphasize its assistance in the areas of basic human needs and economic recovery whilst respecting the Zambian government's ownership and attempting further improvements in aid efficiency. In the 2000 Country Assistance Plan, the following five areas are specified as the priority areas: 1) assistance towards poverty reduction, mainly through agricultural development; 2) enhancement of cost efficient healthcare services; 3) assistance in achieving balanced economic structural reforms; 4) human resources development to achieve self-sustainable development; and 5) promotion of regional integration.

Japan has been active in building Zambia's infrastructure, especially in road infrastructure. The Lusaka city road improvement and maintenance project that commenced in 2001 has completed in 2004. Technical assistance was mainly in the healthcare, agriculture and education sectors.

Table 2.6: Recent ODA to Zambia

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-7.89	41.65	13.27	47.04
2002	21.40	32.34	14.64	68.38
2003	-7.68	19.55	16.45	28.32
Cumulative Total	312.21	709.30	307.04	1,328.58

Source: Compiled by MOFA from OECD/DAC

(2) United States

With an annual budget of about US$30 million, USAID's current development activities focus on four key areas: 1) agriculture and economic growth; 2) basic education; 3) integration of population, health and nutrition programs; and 4) democracy and governance[39]. The Country Strategic Plan for 2004-10 aims to "increase private sector competitiveness in agriculture and natural resources". The key focus of this economic growth strategic objective is on attaining significant improvements in Zambia's competitive position within the region and internationally.

As one of two key main vehicles of accomplishing the objective, USAID has awarded a US$10 million contract to a consortium of firms led by Development Alternatives Incorporated (DAI) to assist in achieving the objectives of its economic growth strategy, which will implement a program of increasing "Market Access, Trade and Enabling Policies (MATEP)". The overall objective is to increase the level of Zambian agriculture and natural resources exports into regional and international markets. This project will contribute to Zambian government's private sector development plan.

(3) World Bank

The Country Assistance Strategy (CAS) for 2004-07 is aligned with the government's PRSP and TNDP through three strategic priority areas: 1) diversified and export-oriented economy; 2) improved lives and protection of the most vulnerable; and 3) a well managed public sector. The World Bank currently has twelve projects amounting to US$633.1 million. These projects are divided in between

[39] USAID Zambia.

three strategic priority areas: 1) removing constraints to sustainable and diversified growth; 2) improving governance; and 3) increasing access to basic services and direct poverty interventions.

3. TANZANIA

3.1. Trends of Macro Economy, Industry, Trade and Industry

3.1.1 Macro Economy

Since the 1990s, Tanzania has undergone a significant transition from Julius Nyerere's African brand of socialism to open market policies that take into account the realities of the new global economic order. A whole gamut of economic reforms have been instituted including the lifting of foreign exchange controls, price control deregulation, the liberalization of agricultural marketing boards, privatization of state owned parastatals, and the implementation of a new investment code offering competitive incentives for foreign investment.

As of October 2003, the PRGF was renegotiated with the IMF. This took place after the Tanzanian Government successfully completed a previous 3-year PRGF arrangement with the International Monetary Fund ending June 2003, the successor programme to the ESAF. From 1996-1999, Tanzania had an ESAF agreement. Tanzania also embarked on a major restructuring of state-owned enterprises. The program has so far divested over 340 out of some 425 parastatal entities. Overall, real economic growth has averaged about 4% a year, much better than the previous 20 years, but not enough to improve the lives of average Tanzanians. Also, the economy remains overwhelmingly donor-dependent. Moreover, Tanzania has an external debt of US$7, 5 billion. The servicing of this debt absorbs about 40% of total government expenditures. Tanzania has qualified for debt relief under the enhanced Highly Indebted Poor Countries (HIPC) initiative. Debts worth over US$6 billion were cancelled following implementation of the *Paris Club VII Agreement*.

Agriculture dominates the economy, providing more than 60% of GDP and 80% of employment. Cash crops including coffee, tea, cotton, cashews, sisal, cloves and pyrethrum account for the vast majority of export earnings. The volume of all major crops--both cash and goods, which have been marketed through official channels--have increased over the past few years, but large amounts of produce never reach the market. Poor pricing and unreliable cash flow to farmers continue to frustrate the agricultural sector.

Accounting for only about 10% of GDP, Tanzania's industrial sector is one of the smallest in Africa. It was hit hard during the 2002-2003 drought years by persistent power shortages caused by low rainfall in the hydroelectric dam catchment areas, a condition compounded by years of neglect and bad management at the state-controlled electric company. Management of the electric company was contracted to the private sector in 2003. The main industrial activities include producing raw materials, import substitutes, and processed agricultural products. Foreign exchange shortages and mismanagement continue to deprive factories of much-needed spare parts and have reduced factory capacity to less than 30%.

The last unexplored frontier, but one with the most potential, is the energy sector, especially the petroleum and gas and the electricity sub-sectors that remains underdeveloped at this stage. Oil and gas exploration has taken place intermittently over the past 40 years, with only two significant gas discoveries (Songo and Mnazi Bay). But preliminary seismic tests suggest that significant oil reserves might exist off the Tanzanian coast.

Table 3.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	12.0	16.2	22.2	30.0	32.1	32.9	33.7	34.5	35.2	35.9
Population ages 0-14 (% of total)	46.3	47.5	47.0	46.0	45.8	45.6	45.5	45.2	45.0	44.7
Population ages 15-64 (% of total)	51.4	50.1	50.5	51.5	51.8	52.0	52.1	52.4	52.6	52.9
Population ages 65 and above (% of total)	2.3	2.3	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4
GDP (constant million 2000 US$)	-	-	6,426.1	7,748.5	8,344.2	8,638.7	9,079.3	9,646.0	10,344.0	11,079.0
GDP growth (annual %)	-	-	5.4	2.9	3.7	3.5	5.1	6.2	7.2	7.1
GDP per capita (constant 2000 US$)	-	-	260.1	257.8	259.7	262.4	269.5	280.0	294.0	308.7

Official exchange rate (LCU per US$, period average)	7.1	7.7	59.6	540.8	664.7	744.8	800.4	876.4	966.6	1,038.4
Inflation, consumer prices (annual %)	11.5	13.7	30.6	20.1	12.8	7.9	5.9	5.1	1.0	3.5
Money and quasi money (M2) as % of GDP	-	-	16.1	19.3	17.5	17.4	18.0	18.3	19.5	20.7
Real interest rate (%)	-	-	-4.9	2.9	7.6	9.3	13.1	12.2	9.4	8.3
Foreign direct investment, net inflows (% of GDP)	-	-	0.1	2.2	2.1	6.0	5.1	3.5	2.5	2.4
Foreign direct investment, net inflows (% of gross capital formation)	-	-	0.0	12.9	14.8	38.5	29.0	20.4	12.9	12.9
Agriculture, value added (% of GDP)	-	-	46.0	46.6	44.8	45.1	45.0	44.7	44.7	45.0
Industry, value added (% of GDP)	-	-	17.7	15.3	15.4	15.5	15.7	15.9	16.2	16.4
Manufacturing, value added (% of GDP)	-	-	9.3	7.6	7.4	7.3	7.5	7.4	7.3	7.2
Services, etc., value added (% of GDP)	-	-	36.4	38.0	39.8	39.4	39.2	39.4	39.2	38.6
General government final consumption expenditure (% of GDP)	-	-	17.8	13.1	7.8	7.9	8.5	9.3	9.6	11.4
Household final consumption expenditure, etc. (% of GDP)	-	-	80.9	84.7	93.1	89.3	82.2	82.1	78.8	79.1
Final consumption expenditure (% of GDP)	-	-	98.7	97.8	100.8	97.2	90.7	91.4	88.4	90.5
Gross capital formation (% of GDP)	-	-	26.1	20.2	13.8	15.5	17.6	17.0	19.1	18.6
Exports of goods and services (% of GDP)	-	-	12.6	15.8	13.6	13.5	14.4	16.3	17.1	18.3
Imports of goods and services (% of GDP)	-	-	37.5	33.7	28.3	26.2	22.7	24.7	24.6	27.4
Gross domestic savings (% of GDP)	-	-	1.3	2.2	-0.8	2.8	9.3	8.6	11.6	9.5
Gross capital formation (% of GDP)	-	-	26.1	20.2	13.8	15.5	17.6	17.0	19.1	18.6
Food exports (% of merchandise exports)	-	62.6	62.0	66.6	64.8	70.1	66.2	61.1	61.3	59.0
Food imports (% of merchandise imports)	-	9.7	6.5	15.5	19.9	16.2	14.6	15.2	13.8	13.2
Agricultural raw materials exports (% of merchandise exports)	-	19.8	20.4	15.3	11.4	13.2	13.4	13.2	11.1	11.6
Agricultural raw materials imports (% of merchandise imports)	-	1.2	1.2	2.3	2.2	2.2	2.5	2.2	2.5	1.8
Ores and metals exports (% of merchandise exports)	-	1.6	2.9	0.7	0.9	0.8	0.5	8.8	12.5	9.2
Ores and metals imports (% of merchandise imports)	-	1.9	1.9	1.6	1.1	1.1	1.2	1.1	1.3	0.9
Fuel exports (% of merchandise exports)	-	3.6	1.5	0.6	1.6	0.3	0.1	0.2	0.1	2.0
Fuel imports (% of merchandise imports)	-	15.6	22.1	9.5	8.9	8.0	18.5	12.9	11.7	18.5
Manufactures exports (% of merchandise exports)	-	12.3	12.9	16.6	21.0	15.5	19.6	16.6	14.9	18.1
Manufactures imports (% of merchandise imports)	-	71.6	68.3	71.0	67.8	72.4	63.1	68.5	70.7	65.5
Aid per capita (current US$)	3.3	17.4	34.3	33.8	31.1	30.1	30.3	36.9	35.0	46.5
Total debt service (% of exports of goods and services)	-	13.4	32.2	22.8	21.0	18.5	12.8	10.2	6.7	5.1
Total reserves in months of imports	-	1.5	0.4	2.6	2.9	3.9	5.2	5.8	7.9	8.8

The World Bank (2005), *World Development Indicators: 2005*

3.1.2 Industry

Under the many years of former President Nyerere's clever leadership, Tanzania maintained a stable domestic administration adopting economic policies that stressed independency and agriculture. Since adapted African-socialism did not succeed to lead the national economy on sustainable development railway, in the late 1980s coinciding with the timing of a change in the presidency, a gradual shift was made toward economic policies that moved toward a market economy and private sector development. In recognition of this, since the late 1990s when privatization in particular was accelerated and the mining sector was opened up to foreign investment, there has been an increase in the influx of FDI and foreign aid. While the government's policy had been that the principal industry, including that for exports, was agriculture for many years, production of consumer goods for domestic markets was undertaken on a limited scale mainly by Indian businesses. In recent years, mining, which has been stimulated by foreign investment, has gained prominence as the new mainstay industry. Also, tourism is an important key industry together with neighbouring Kenya, in which was seen the inward flow of FDI.

Looking at Tanzania's industrial structure by industry, the percentage of GDP that agriculture accounted for in 2002 was a high 44%, followed by mining and manufacturing at 16% (of this manufacturing accounted for 9%), and the service industry at 39%. These ratios have hardly changed compared with those at the beginning of the 1990s, but if one takes into consideration the 5% growth which has continued since 1999, domestic industries have improved in a comparatively balanced way.

Citing the main sub-sectors of each industry, the principal products of the key agriculture industry are self-sufficiency crops represented by maize, cash (export) crops including coffee, cashew nuts, cotton, tobacco, pyrethrum (an insecticide made from chrysanthemums), tea and sisal, as well as a variety of vegetables and fruits which are applicable to both kinds of crops. As widespread use of mechanization and irrigation methods of agriculture has yet to take hold and both kinds of crops are mainly cultivated on small farms, production amounts are influenced by the weather, and most of the crops headed for export are unprocessed. The livestock sector is steadily growing, but production targets domestic consumption. In the fishing industry, Nile Perch and other fish are caught mainly in Lake Victoria and exported, but coastal fishing remains untapped along most of the nation's long ocean coastline. Zanzibar has a long history as a world center for such spices as cloves.

In the mining sector of secondary industry, Australian and South African companies have continued to make inroads as restrictions on private participation including foreign capital in the mining industry have been phased out, and gold production has risen dramatically. Gold production in 2002 was 43 tons, which made the country the second largest producer and exporter in Africa after South Africa. Since 2000, the production of precious stones such as diamonds and tanzanite as well as limestone has also increased. Elsewhere, while there is a certain amount of growing support for food processing which accounts for close to 50% (45% value added) of the whole manufacturing industry with oil refining and chemicals at 7%, machinery at 5%, textiles and leather at 1%, followed by paper manufacturing and metal processing, this is only a thin layer mainly destined for domestic consumption, with the exception of some categories such as processed agricultural products. However, since the mid-1990s, privatization of public enterprises has progressed, and some companies have emerged, which have shown improved productivity and modernization enough to conquer even overseas market, sometime with the introduction of foreign capital.

As for the service industry, other than noticeable advances of mainly South African foreign investment in the distribution sector, the IT field has rapidly expanded led by foreign investment in the cellular phone businesses. Public service enterprises, such as ports, electric power, transportation, communications and water supply have continued to move toward forms of business using private enterprises. Tourism which is one of the nation's main sources of foreign currency is also developing. The number of tourists who visited this nation, which has Mt. Kilimanjaro and wild animal preserves, increased from 150,000 in 1990 to 550,000 in 2002, and tourism revenue also reached US$730 million. In addition to a stable political and security situation, growth of the tourism sector also contributes to investment in new equipment and facilities through foreign investment.

3.1.3 Trade and Investment

(1) Trade

Tanzania’s continuous trade deficit has been decreasing mainly due to the export increase. Although Tanzania’s traditional exports are coffee, cotton, sisal, tea, tobacco and raw cashew nuts, non-traditional exports include petroleum products, minerals and manufactured goods is also increasing.

Its main trading partners are UK, Japan, Kenya, France, India and Netherlands. Tanzania imports consumer goods, machinery and transport equipment, crude oil and industrial raw materials. Most of the products are supplied by South Africa, Japan, India, United Arab Emirates, China, Kenya and UK.

Tanzania’s efforts to strengthen the external position have focused on reversing the decline or traditional exports and increasing non-traditional, that is, agro-industry and manufacturing exports, as well as attracting FDI and other financial flows. The country’s trade policy is also pursued within the framework of the SADC trade protocols and the East African Community Treaty.

Table 3.2: Trade tendency and main partners

（US$ million）

	1998	1999	2000	2001	2002
Export	1,144	1,190	1,307	1,431	1,563
Import	2,375	2,242	2,064	2,232	2,218
Main trading partners					
Export India	116.79	113.16	98.82	109.10	118.40

	United Kingdom	60.97	95.47	148.17	46.13	52.69
	Germany	49.11	36.32	66.85	55.19	37.17
Import	South Africa	129.38	170.84	174.41	197.80	214.67
	United Kingdom	121.53	128.30	106.48	104.42	100.84
	Japan	129.58	178.09	142.12	83.02	75.51

Source：World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

The increase of FDI inflow to Tanzania is widespread in all sectors with manufacturing, tourism, services and mining showing the largest increases. However, it is pointed out that employment creation only marginally increased. This indicates increasing FDI inflows of a capital intensive nature which has been a feature of most investment into the region in recent years. Labour intensive investments remain unpopular with foreign investors given the onerous compliance costs associated with the hiring of local labour. The largest foreign investors in the country originate from Ghana, United Kingdom, South Africa, Japan and more recently China.

Table 3.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
172.2	541.7	282.0	467.2	240.4	248.0

Source: UNCTAD, FDI On-line.

Table 3.4: Largest affiliates of foreign TNCs, 1998

(US$ million and number)

Company	Host economy	Industry	Sales	Employees
Ashanti Goldfields (Tanzania) Ltd.	Ghana	Mining	284.4	20
Tanzania Breweries Ltd. (South African Breweries)	South Africa	Beverages	185.9	1,266
Tanzania Tobacco	Japan	Tobacco	107.1	773
Total Tanzania Ltd.	France	Distributive trade	32.7	88
Computers & Telecoms Systems (Tanzania) Ltd.	United Kingdom	Computer & related activities	4.2	105
Service and Computer Industries Ltd.	Kenya	Computer & related activities	0.7	33
East African Development Bank	Uganda	Banking	151.1	…
Stanbic Bank Tanzania Ltd.	South Africa	Banking	140.5	159

Source: UNCTAD, FDI in brief: Tanzania

Tanzania has large gas reserves and interesting oil exploration prospects although these have never been officially confirmed. Between 1954 and 2000, 25 potential oil wells and eight delineation wells were drilled at Songo Songo Island off Kilwa. Twenty-three wells were drilled in the coastal basins and two in the interior Rukwa basin in south-western Tanzania. No commercial oil discovery has taken place so far. However, seismic and hydrocarbon tests have shown that a large area of Tanzania’s coastal belt, the Rufiji river valley and delta and the western flank of the Great Rift Valley in Rukwa region have potential oil.

Several large oil corporations including Shell Explorations of the Netherlands and the Tanzania Petroleum Development Corporation (TPDC) have started with negotiations concerning deep-sea exploration.

3.2. Policy Issues Promoting FDI

3.2.1 Industrial Policies and Development Plans

Since 2000, the government, together with creating a healthy macro-economic environment, has continued to privatize public enterprises and their utilities by promoting private sector business in its transformation to a market economy. In industrial development policies by sector, investment from the state's coffers has emphasized expanding lending mechanisms and developing an irrigation network in the key agriculture sector, as well as building up social infrastructure in rural areas. In the mining sector, further deregulation is being undertaken, and in the manufacturing sector, fiscal disbursements are currently being augmented mainly to reduce burdens and obstacles to management such as the establishment of special export zones, as well as to ameliorate power shortages and inadequate transportation networks which lead to increased costs. Additionally, the nation has set a target of becoming a new industrializing country by 2025, and formulated a long-term economic development plan, so called ‘’Mini Tiger Plan’’, the core of which focuses on the enforcement and diversification of private sector.

3.2.2 FDI Promoting Policies

Tanzania officially welcomes foreign investment under the investment regime established by the 1997 *Tanzania Investment Act*, which established Tanzania Investment Centre (TIC), identified investment priorities, overhauled the company registration process, and established investor rights and incentives. Investors must be licensed and must meet minimum capital requirements.

In December 2001 Prime Minister Frederick Sumaye outlined five steps to make the country more conducive for investment:

- Simplifying licensing requirements and associated entry restrictions.
- Rationalising and simplifying the tax system.
- Improving export-shipping procedures.
- Removing bureaucratic delays in decision making, licensing and in approval mechanics; and
- Putting in place a transparent and one stop approval investment centre through the Tanzanian Investment Centre (TIC).

Linked to this has been the implementation of a well-balanced package of investment benefits and incentives that are applied uniformly to all investors (domestic and foreign) and systematically as specified by law (the *Tanzania Investment Act, 1997 No. 26 of 1997*)

In 2003, the Director of Investment Promotion of the TIC, Emmanuel Ole Naiko, announced that TIC would be targeting specific countries such as Mexico, Argentina, Australia, Europe and the United States as well as South Africa, Libya and Kenya. With the manufacturing, tourism and mining sectors attracting investors, the TIC will now promote agriculture. Naiko also said that investors are encouraged to produce finished products for export and they are granted generous incentives, which includes tax relief and guarantees of suitable infrastructure.

Current concern is directed towards issues of legal and regulatory reforms as part of an enabling business environment. The object is to create national competitiveness platforms upon which investors can create specific product competitive edges that are necessary for effective international market access.

In more specific terms, market supporting institutions that have been established include: the Public Sector Reform Commission (PSRC) with the mandate for divestiture of State Owned Enterprises; the TIC with the role of investment promotion; the Tanzania Revenue Authority (TRA) responsible for the management of the tax regime; and the Fair Competition Commission (FCC) whose role includes the protection of consumers through mitigation of the tendencies and effects of concentration of economic power exercised by monopolistic firms.

Driving this is the National Development Corporation (NDC), a public institution established in 1992. Its primary objectives are to identify, mobilize and channel investment resources into development of projects that have high inherent catalysts to enhance exploration of economic growth potential, and to initiate economic projects, either alone or in partnership with the private sector (local and foreign), to facilitate the development of world-class, competitive industries.

In response to this mandate, NDC is co-ordinating and leading the implementation of two distinct but complementary programmes: the Export Processing Zones (EPZs) and the Spatial Development Initiatives (SDIs).

With respect to policy frameworks guiding decision making on socio-economic developments issues related to development aid, a guiding programme for the country’s development prospects programme is what is known as the Tanzanian Assistance strategy (TAS) started in July 2002. The TAS is a national strategy to promote Government leadership and ownership of the development agenda, improve the effectiveness of aid, encourage harmonization and alignment, strengthen development partnerships, and reduce transaction costs in development co-operation. The TAS is a unique initiative that resulted from a joint understanding between the Government and Development Partners that there is an urgent need to improve the efficiency and effectiveness of external resources in order for Tanzania to achieve its poverty reduction goals. The core idea of the TAS is that this should happen under the leadership of the Government and the ownership of the people of Tanzania.

Another important component of the country’s development plans is giving consideration to greater decentralisation of decision making to provinces and local districts. This will impact quite significantly on the development of businesses, as local and provincial councils will have a greater say in the delivery of services to new projects.

(1) Spatial Development Initiatives

The Government has appointed NDC as the initiating and coordinating agent for the implementation of the Spatial Development Initiative (SDI) or development corridors in the country. The development corridor programme forms part of the country's economic strategy in enhancing the attractiveness of investment opportunities to domestic and foreign investors. So far, five development corridors have been identified: the Mtwara; Central; TAZARA; Tonga and the Lake Zone corridors. Strategies for the implementation of the different development corridor initiatives are at different stages.

For operational reasons, the Government accords priority to the Mtwara Development Corridor (MtDC) and the Central Development Corridor (CDC). Preliminary investigations and studies have been undertaken in the case of the priority corridors and a number of investment project concepts have been identified.

The main objective of the Development Corridor Programme is to unlock currently underutilized economic resources in key sectors ranging from agriculture natural resources to mining and tourism that are inherent in vast stretches of Tanzania.

3.3. Incentives and Impediments for/to FDI

3.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

<u>1) Tanzania Investment Centre (TIC)</u>

The TIC is the focal point for all investors entering the country, established in 1997 by the Tanzanian Investment Act No.26 of 1997. According to its own literature it is the first point of call - a “one stop facilitative centre for all investors”, engaging in the business of marketing Tanzania as an investment destination. It offers assistance in the establishment of enterprises and provides facilitation services for required permits and licenses for both local and foreign investors. All Government departments and agencies are required by law to cooperate fully with TIC in facilitating investors. TIC issues the formal Investment Certificate of Incentives, which serves as the official recognition of one's status in the country.

Additionally in an effort to improve investors service, the TIC has adopted a new operational system by introducing "Relationship Manager" concept. Each "Relationship Manager" is assigned a portfolio of investment projects, which he/she is responsible for servicing throughout the investment process. This includes providing information, assisting investors to obtain approvals and permits without requiring the investors to move from one office to another. The investors obtain all their requirements at TIC.

TIC received the first prize at the Africa Investment Promotion Agencies 2004 competition, where 48 countries took part.

<u>2) Presidential Parastatal Sector Reform Commission (PSRC)</u>

TIC does not cover all sectors of the economy. There also exists the Presidential Parastatal Sector Reform Commission (PSRC), established in 1992, that governs all investments related to the privatization of state parastatals. The PSRC effectively controls the privatization process of any parastatal process, answerable to the cabinet only – from the preliminary strategy that addresses debt allocation, labour policy and transaction to signing of contracts and transfer of titles.

<u>3) Zanzibar</u>

Zanzibar operates a separate Investment Promotion Agency (ZIPA) , which was established in 1991. Like its main-land counterpart, ZIPA aims to create a welcoming environment for foreign investors and provides similar incentives.

(2) Export Processing Zones

The *Export Processing Zone (EPZ) Act* introduced in 2002, has enabled the establishment of EPZs throughout the country. EPZ incentive packages are managed by the National development Corporation (NDC), independently from TIC. The government has established one EPZ business park for the purpose of attracting export industry investment, but EPZ benefits do not depend on location in a specific geographical area. Rather EPZ status reflects unique benefits offered to export industries. EPZ companies must export at least 70% of goods produced, and export at least US$100 000 to qualify to apply for EPZ status.

EPZ status is available to both domestic and foreign investors, but is currently limited to "new export companies”, thus excluding established exporters from benefiting. Companies investing within the

EPZ park have access to ready-made buildings and reliable infrastructure, which limits the need for large capital investments in infrastructure. The EPZ policy places emphasis on products that use local materials such as textiles and garments, leather goods, agro-processing, and the lapidary industry. Historically, large job-creating investments (in the textile industry, for example) have received significant incentives packages.

Tanzanian EPZ programme is based on two premises: the concept of using the EPZ as a platform to serve as an international gateway to regional and global markets; and that of establishment of strategic nodes of industrial development based on enhanced access to facilities for the processing of national resources within the framework of designated development corridors. Is should be noted that, in the context of accessing the market of more than 200 million people in nine landlocked countries in the East and Central African region, Tanzania's sea and lake ports provides the basis for concrete competitive advantages to investors. Proposed EPZ development areas seek to capitalise on this geographical advantage and to minimise transport costs to target markets and international trade gateways.

(3) Incentives for FDI

A range of mechanisms and incentive instruments exist to encourage foreign investment in the country. The most significant are what are called “Certificates of Incentives” issued by the Tanzania Investment Centre under authority conferred upon it by Part III, Section 17 (1-8) of the Tanzania Investment Act, 1997, that allow for important concessions for would be investors.

To qualify for and obtain TIC Certificate of Incentives, minimum fixed investment cost for new, rehabilitation and expansion projects should be at least US$100 000 for projects which are 100% citizen owned or a locally registered company whose majority shares are held by citizens, and US$300 000 for projects which are 100% non-citizen owned, joint venture or a company which is incorporated under laws of any country other than Tanzania.

Investments in Zanzibar are regulated by the *National Investment Promotion Act of 1986* (under revision), outlining provisions and incentives for investments in areas of priority. Through the Zanzibar Investment Promotion Agency (ZIPA), Zanzibar supplies the various investment incentives similar to those provided by TIC for the most part.

<u>1) Tax Exemptions/Tax Holidays</u>

The incentives available to the holders of TIC certificates are as follows:

- Reduced import tariff on project capital items (5% import duty for investments in priority sectors and ZERO% for investment in Lead Sectors).
- Favourable investment allowances and deductions i.e. capital allowance (100%) on industrial buildings, plant and machinery and on agricultural expenditure.
- Deferment of VAT payment on project capital goods as defined in the tariff book and its relevant annexes deferred VAT to be shown on monthly return after which it will be extinguished unless it is discovered otherwise after audit.
- Imports Duty drawback on raw materials.
- Zero-rated VAT on Mining inputs, Agriculture inputs, goods manufactured for exports, foodstuff and tourism.
- Straight line accelerated depreciation allowance on capital goods.
- Yearly appreciation of unrecovered capital in investment in mining.
- Up to five years carryover of all business losses against future profits.
- A reasonable corporate tax rates 30% and low withholding tax on loan interest payments.

In addition for exporters, there is exemption from foreign exchange control restrictions, exemption from the pre-shipment inspection requirement, and on-site customs inspection instead of off-port inspection.

The mining sector also benefits from generous tax relief. The sector was given a major boost in 1997 following the formulation of *Mining Policy* and enactment of a new *Mining Act of 1998,* which repealed the Mining Act of 1979. This law has been enacted to remove ambiguities that prevented smooth operation of the sector. Elements of the fiscal incentive package are offered for the sector.

2) Tariffs and Customs

As part of the East African Customs Union, Tanzania imposes the EAC common external tariff on goods from non-EAC countries. The current rate structure has three tariff bands: 0%, 10%, and 25%.

- 0% Applies to raw materials and certain agricultural and industrial inputs.
- 10% Charged on semi-processed inputs and industrial parts.
- 25% Charged on final consumer goods.

Selected list of sensitive goods are rated at higher rates, up to 100 percent. In addition, Value Added Tax (VAT) of 20% is charged on all imports, except for the above incentives to TIC certificates holders.

(4) Impediments to Attract FDI

According to an Investment Climate Assessment survey done in 2003 and released in November 2004 by the Economic and Social Research Foundation (ESRF) in Dar es Salaam and the Regional Programme on Enterprise Development at the World Bank, the five major impediments on investment or enterprise operations and growth were identified, which include tax rates, electricity, cost of finance, tax administration and corruption.

1) Taxation and Tax Administration

Almost 73% of enterprises in Tanzania rated tax rates as a major or very severe constraint on enterprise performance and growth – considerably more than rated any other obstacle, including corruption. While corporate tax rates are comparable to the rest of the world at 30%, company executives revealed that the multiplicity of national and local taxes is a major source of dissatisfaction. They also reported that they spend about seven days in a year dealing with inspections or required meetings with tax officials. The burden of tax administration is particularly high on more productive firms, which tend to be larger and are more likely to be foreign owned. Corruption around tax administration is also a problem.

The Government of Tanzania is now implementing the new tax charter with a view to establishing a tax regime that is more transparent, equitable, efficient, and that will increase revenues, based on the consultation with private sector business associations, including an investors roundtable group.

2) Corruption

Transparency International has consistently rated Tanzania as one of the more corrupt countries in the world. Despite the laws, regulations and penalties to combat corruption, enforcement is ineffective. Areas in which corruption persists include government procurement, privatisation, taxation, ports, and customs clearance. Petty corruption is especially bad – payments made to low-level government officials to “get things done” in connection with red tape obstacles i.e. custom clearances, taxes, licences, and other services.

3.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

Tanzania is one of the most advanced countries in "Donor Coordination". It is matter of course that development of physical infrastructure is the area of coverage. Thanks to such strong commitment from donors, roads for instance steadily have been taking place the rehabilitation and construction program. But it is still widely recognized that infrastructure is the hindrance for business activity. This is proven by the fact that Tanzania Investment Center (TIC) identifies infrastructure development as the priority sectors and provides incentives.

The existing comprehensive road network in Tanzania can reach any part of the country[40]. Government has prepared a road upgrading and rehabilitation programme to improve accessibility to economically productive areas, particularly in the agricultural, tourism and mining sectors. International airlines operate in and out of Tanzania through Dar es Salaam and Kilimanjaro airports, and another international airport at Zanzibar. There are also several regional airports and numerous landing strips for use by charter planes. Two railway companies dominate the country's rail network[41]. The Tanzania Railways Corporation (TRC) is one of the country's largest infrastructure enterprises providing transportation of goods (domestic goods, import and export cargo) and passengers within the country, and transit traffic to the land-locked countries[42]. The inland navigation network on the great lakes covers around 4,300 kilometres. Objectives in privatising the Tanzania Harbour Authority (THA) are to improve efficiency of port operations and enhance quality of services offered to customers, to improve the port's competitiveness over other regional ports, and to improve profitability of port operations.

Electricity is perceived as the most severe obstacle[43]. It was hit hard during the 2002-2003 drought years by persistent power shortages caused by low rainfall in the hydroelectric dam catchment areas, a condition compounded by years of neglect and bad management at the state-controlled electric company. Electricity generation is largely hydro-based with three main generation stations linked together through the national grid. A number of stand-alone thermal generation stations that are not linked to the national grid supply remote district townships and the rest of rural areas. Those areas outside the grid are served by diesel generating units. Although management of the electric company was contracted to the private sector in 2003[44], Power tariffs are still very high in comparison with other countries in the region and the supply is irregular and insufficient.

Regarding Telecommunications sector, the main operator, Tanzania Telecommunications Company Ltd (TTCL), which operates fixed line basic telephony services and enjoys a monopoly in mainland Tanzania, and a duopoly in Zanzibar. Internet services have expanded rapidly in Tanzania. There are presently more than 100 Internet service providers operating in the country.

(2) Regional Programme

In 2003, Tanzania, Kenya and Uganda held a consultative meeting with the European Union and World Bank to establish the East African Community (EAC) Infrastructure Development Programme.

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[40] The road network consists of 85,000 km of classified roads, of which 10,300 km are trunk routes. The Island of Zanzibar has 619 km, 442 km of which is tarred, while Pemba has 363 km, with 130 km being paved.
[41] Total length is 3,690 km, of which 969 km are narrow gauge(1.067-m); 2,721 km are broad gauge (1.000-m)
[42] TAZARA railway is jointly run by two governments through Tanzania-Zambia Railway Authority.
[43] Tanzania plans to increase its generating capacity to around 1,800 megawatts through several projects. The Tegeta IPTL power plant will generate about 100 megawatts; the Ruhudji hydro project will generate 358 megawatts by 2012; the Kinyerezi combustion turbine-gas will generate 820 megawatts by 2005; and the Rumakali hydro project will generate 222 megawatts by 2018.
[44] The South African engineering consulting group Net Group took over the corporate management to ready the company for privatization. Net Group Solutions succeeded in turning the company around financially but has not completed the task of technically turning around. Since last year, power outages have becoming the order of the day, and it would seem that Net Group's contract is likely to be terminated.

The most important components will be the improvement of the cross-border telephone connection, civil aviation safety, a five-year meteorological development plan and the development of the regional road and railways networks and a power master plan. Some of these programmes are attained through the Spatial Development Initiative (SDI) or development corridors in the country. The National Development Corporation (NDC) has been appointed as the initiating and coordinating agent for the implementation. So far, five development corridors have been identified: the Mtwara; Central; TAZARA; Tonga and the Lake Zone corridors. For operational reasons, the Government accords priority to the Mtwara Development Corridor (MtDC) and the Central Development Corridor (CDC).

Mtwara Development Corridor: The Mtwara Development Corridor was conceived as part of regional development initiatives under the framework of the Southern African Development Community (SADC). It involves partnership of four neighbouring Southern Africa countries: Malawi, Mozambique, Tanzania and Zambia. In Tanzania, the corridor territory covers the southern regions of Mtwara, Lindi, Ruvuma, Iringa, Mbeya and Rukwa, and the area south of Rufiji River in Morogoro and Coast regions, covering about 387,726 sqkm. Project scanning undertaken in Tanzania identified a number of investment schemes in two areas: that of economic services infrastructure and that of economic development generators.

Infrastructure Projects currently underway in this corridor include the following:

- Mchuchuma - Katewaka- Coal Mine.
- Mchuchuma Thermal Power Station.
- Upgrading Manda Village to township level, which include development of infrastructure such as roads.
- Transmission system to evacuate power from the Mchuchuma.
- Project to the National Power Grid.
- Development and upgrading of Lindi, Mtwara and Kilwa ports along the Indian Ocean, and Manda and Mbamba Bay ports along Lake Nyasa.
- Development of the Mtwara, Songea anc Njombe airports Mchuchuma-Mlimba Road
- Unity Bridge and Ferry Crossing at Ruvuma River to Mozambique.
- Mtwara - Mbamba Bay Road.
- Construction of the Mtwara - Songea - Manda Railway.
- Construction of the Manda - Mchuchuma - Mlimba Railway.
- Rehabilitation and expansion of Urban and Industrial Water.
- Works in Iringa, Mbeya, Rukwa. Ruvuma. Mtwara and Lindi regions.

The Central Development Corridor: The Central Development Corridor is another regional development initiative potentially involving five countries of the Great Lakes. These are Burundi, the Democratic Republic of Congo, Rwanda, Tanzania and Uganda. The corridor connects the four landlocked countries to the seaport of Dar es Salaam. The corridor runs through the relatively densely populated plateau of central Tanzania, covering regions of Dar es Salaam, Morogoro and Dodoma. Other regions include Singida, Tabora and Kigoma on the shores of Lake Tanganyika, and Shinyanga and Mwanza on the shores of Lake Victoria.

Project scanning conducted in the area has identified the following projects:

- Roads: (a) Morogoro - Dodoma - Manyoni - Tabora - Nzega - Isaka; (b) Nzega - Singida - Manyoni; (c) Tabora - Kigoma; (d) Tabora – Mbeya region border and Mpanda; (e) Mpanda - Kigoma; and (f) access roads.
- Railways: Concessioning and improvement of TRC central railway system.
- Maritime/marine Services: Concession/ leasing and improvement of Sea/Lake ports (or terminals) and services.
- Aviation: Leasing and improvement of major airports or airfields e.g. Mwaza, Bukoba, Kigoma (also for freight traffic to DRC), Tabora, Isaka.

- Logistics: Establishment or improvement of terminals/ facilities and facilitation along logistical chains.
- Communications: access to and higher penetration of telecoms and ICT services.
- Energy: access to national electricity grid.
- Water resources: access to reliable water for domestic and industrial use.

(3) Trend in Privatisation and Some Observations on Current PPPs

Since the late 1990s, Tanzania has embarked on a fairly steady programme of privatisation and deregulation in key strategic sectors of the economy where parastatals dominate.

The Government's policy towards the transport sector over the last decade has been for steady deregulation with the result that the private sector has entered the market. Furthermore deregulation of imports and increased public spending on roads resulting in significantly improved roads conditions has increased the level of competition from the private sector in the transport sector.

In April 2000 the Government made the decision to create two independent multi-sectoral regulatory agencies, one to regulate the utilities, the other to regulate three forms of transportation covering rail, land and maritime. As for the regulator in charge of transportation sector, the legislation enabling the creation of a new agency was tabled and passed in the April 2001 parliamentary session, and assented and printed in June 2001 as the Surface and Marine Transport Regulatory Authority(SUMATRA) Act 2001. The Authority started its operations on 20th August 2004.

On 1 March 2005, the Minister of Foreign Affairs and presidential candidate Jakaya Kikwete, said if he were elected as President in October this year, he would make privatisation of public corporations more transparent. Under his administration, privatisation of public property would not be conducted "under the carpet", reflecting concern over the conduct of the exercise.

3.3.3 Currency and Monetary Systems

(1) General Conditions

Bank of Tanzania (BOT) has been successfully controlling the inflation rate at a relatively low level among Subsaharan countries without adopting an excessive tight money policy. It continued to firmly maintain its tight money policy in the second half of 2004 and set the discount rate at 14.5% at the year-end.

Policy targets of Bank of Tanzania focus on growth of money supply, growth of domestic loans and one-digit inflation rate. Targeted rates of M2 growth and inflation are set at 20 to 24 %, and 4% p.a. respectively up to June, 2005. The same targets are likely to be adopted also in 2005. Tanzanian Shilling will be gradually depreciated in a long run. The exchange rate was TZS1, 043/US$ at the end of 2004, and will be expected to be TZS 1,091/US$ at the end of 2005 according to EIU forecast.

The balance of payment has improved tremendously during the past few years as a result of non-agricultural exports and a steady flow of foreign assistance. Together with debt relief from the IMF, these developments have led to a big increase in international reserves that stand around US$1.5 billion, the highest for over 30 years and equivalent to seven months of import. This has helped BOT to intervene whenever minor fluctuations have led to a slight depreciation of the Tanzanian shilling.

Consequently, the stability of the exchange rate, low inflation and falling interest rates have been major factors behind excellent macro-economic stability that has attracted investors in all major sectors of economy like mining, tourism, manufacturing, services and agriculture.

(2) Banking Sector

The banking industry is growing in Tanzania, with a half dozen international banks expanding operations in the country. As the result of the Government approval of the bill to establish commercial banks in 1991, newly participating banks has promoted financial competitiveness and brought some improvement in terms of quality and quantity to financial services industry. In Tanzania there are 20 commercial banks and 11 non-banks, which have a sum of TZS 1,507.4 billion (US$1,507.4 million) of deposits at the end of December 2002. Venture capital funds including FEDHA Fund, Aureos, and CDC Capital Partners, are also providing money to start-up enterprises.

National Bank of Commerce (NBC), the leading bank occupying 75% share in total assets of banking industry, was divided in 1997 into NBC 1997 Ltd. (sold to Amalgamated Bank of South Africa) and National Micro-finance Bank (NMB). Tanzanian financial sector is improving and developing generally sound on the market principle.

Export finance is granted by NBC, NMB, Cooperative and Rural Development Bank, Stanbic and Standard Chartered Banks, while import finance is supported by donor countries.

While Tanzania has made considerable strides in developing its banking sector, companies continue to report that access and high interest rates are serious problems. According to ERA report, about 58% of companies reported that financing cost was a major or very severe constraint on enterprise operations and growth. Only 16% of investment is financed through the formal banking sector, the rest is done via NGOs, government development institutions or retained earnings.

The insurance market presently consists of 10 insurers, 38 insurance brokers, 285 insurance agencies and 22 loss assessors and adjusters. This sector was once monopolized by National Insurance Corporation (NIC), but the liberalization of the market led to foundation of many insurance firms by overseas and domestic investors.

Restrictions on Financing: Foreign investors are able to get credit on the local market for capital injection within the country and importation of capital goods for use within the country. Each credit application is vetted on its own merit using normal banking procedures and best practices. While credit is allocated on market terms, high interest rates make it uneconomical to borrow from local sources. Bank lending rates range from 14% to 24% for ordinary borrowers. Large corporate borrowers can negotiate lower rates. The private sector has access to a variety of commercial credit instruments including documentary credits (letters of credits), overdrafts, term loans, and guarantees.

(3) Government Financing Schemes

According to the Tanzanian Investment Act of 1997, a foreign investor may, in relation to the business enterprise which he operates, obtain credit from domestic bank and financial institutions up to the limit established by the Bank of Tanzania (BOT) in consultation with the TIC having regard to the amount of foreign capital invested in the business enterprise.

A foreign investor who obtains credit shall ensure that the proceeds of that credit are used solely for the purpose of carrying out the activities specified in his loan application. The bank granting the loan may then appoint its officer or agent to verify the due application of the credit.

Government backed Project financing is available from several local and regional multi-lateral funding agencies. These include the Tanzania Investment Bank ,Tanzania Development Finance Co. Ltd, Commonwealth Development Corporation (CDC), and the Tanzania Housing Bank (THB).

<u>1) Tanzania Investment Bank (TIB)</u>:

It grants medium and long-term loans to economically sound and technically feasible projects in the key industrial and agricultural sectors of the economy. It also undertakes the provided advice to investors.

In addition, it administers special funds for financing small-scale projects and provides technical assistance and advice.

2) Tanganyika Development Finance Company Ltd. (TDFL)

It promotes viable companies in industrial, agricultural, tourist and other undertakings based on the utilization of natural resources and the attraction or savings of foreign exchange. Its focus is on medium-sized projects.

3) Commonwealth Development Corporation (CDC)

It is the British statutory organization and is actively involved in Tanzania's development. It invests in productive projects covering basic development, agriculture and processing, as well as industry and commerce. It mainly provides medium and long-term financing through loans or equity in joint ventures with Government, development agencies, institutions and the private sector.

4) Tanzania Housing Bank (THB)

It provides medium and long-term loan to individuals and organisations to build low and medium-cost, rural and urban housing.

In addition, it grants commercial loans, finances commercial and industrial premises, office blocks, hotels and guest houses, warehouses and the production of building materials. It also has a network of zonal and regional branches.

In addition, the Bank of Tanzania has been working on the development of a regulatory and supervisory framework for microfinance operations in the country; a task expected to be through by June 2004. Operational guidelines and standards for Savings and Credit Cooperative Societies (SACCOS) are expected to be put in place and disseminated to stakeholders. In addition, the database on microfinance will be operational and benchmarks for the microfinance industry will be created. Also, the Parliament approved repeal of the *National Microfinance Bank (NMB) 1997 Act* in November 2003, to pave way for the privatization of the bank.

With the objective of enhancing internal capacity for accessing capital, the Government has promoted the development of Savings and Credit Cooperative Societies (SACCOS), that have shot up from 803 in June 2000 to 1 264 at end-December 2003. The value of shares and savings has increased from Tshs. 14 billion to Tshs 25.7 billion, equivalent to an increase of 83% during the period. Loans also increased from Tshs 11.5 billion, to Tshs 28.5 billion, equivalent to an increase of 117%.

5) Security of Guarantees (domestic and international)

Tanzania is an active member of the Multilateral Investment Guarantee Agency (MIGA), which has been successfully utilised by foreign investors in search of guarantees.

(4) Securities Market

As for securities market, the Dar es Salaam Stock Exchange (DSE) was opened in April 1998. . Capitalization of market price increased from TZS 1,516 billion in 1998/1999 to TZS 1,659 billion in 1999/2000. At present, 7 companies are listed in DSE. Capital Market and Securities Authority (CMSA) was incorporated in 1994 as the organization responsible for fundamental control and supervision over stock exchange. CMSA is also authorized to regulate and issue license on transaction and issuance of securities, exchange transaction and intermediation of investment.

(5) Foreign Exchange Controls

There are few controls governing the movement of capital for companies and foreign nationals. Import and export trade has been facilitated by the abolishment of export and import licences and foreign exchange controls. Regulations permit the unconditional transfer through any authorized bank in freely convertible currency of net profits, repayment of foreign loans, royalties, fees, charges in respect of foreign technology, and remittance of proceeds. The only official ceiling on transfers of foreign currency apply to cash carried by individuals travelling abroad, which should not exceed US$ 10 000 over a period of forty days.

The International Monetary Fund reports that non-residents temporarily residing in Tanzania may hold foreign exchange accounts, but that all transfers of foreign currency from residents to non-residents must be approved by the central bank.

1) Availability of Foreign Exchange

Tanzania occasionally experiences shortages of foreign exchange, but this problem has been eased considerably by the growth of Bureau de change returns. Foreign reserves in the Bank of Tanzania sits on forex worth over US$2,17 billion (2004) billion at the equivalent of eight months worth of imports, one of the highest in the region and well within IMF minimal requirements. Bureaucratic hurdles, however, continue to impact the length of time it takes to process and effect a transfer, which can range from days to weeks.

3.3.4 Labor and Management

Unskilled labour is plentiful and inexpensive[45]. There continues to be dearth of skilled labour in the country, though the number of university graduates is growing, especially in business management and information technology. Many foreign investors find that local labour is not sufficient to fill management and administrative positions. Nevertheless managerial standards are generally high, with 68%[46] of managers holding university degrees. This figure is better than that of neighbours (Uganda 40% or Kenya 60%).

Tanzania passed a revised labour law in 2004[47] that conforms generally to international standards on the point of protection for workers rights. Firms are able to make decisions on employment without the need to report to any specific agencies. But as with most African countries, visa and work permit requirements are onerous on foreign investors. Tanzania Investment Centre (TIC) allowed investors for the qualification of incentives, which employ foreign staffs with specific expertise up to 5 persons. This is a de facto local content requirement on labour.

The country has various regulations that are rather protective for workers rights due to the historical background of being in a long-term socialistic era. Workers enjoy a sufficient degree of protection especially in regard to leave, compensation and employment maintenance. Such conditions are possibly impediments for inward investment from the management viewpoint.

Employees have the right to organise into labour unions, to bargain collectively, and to legally strike under certain conditions. Labour laws apply equally to private and public sector workers including

[45] According to the results of the “Integrated Labour Force Survey 2000/1” released by the Labour Ministry on 15 April 2003, the country has a labour force of 17.8 million people (age 10 years and up) out of a population of 34.6 million. According to the report, 87.1% of the economically active population was employed and only 12.9% or 2.3 million unemployed. Of those who are employed, 84% were engaged in farm/agriculture activities. Over the past 10 years, there has been a gradual increase in unemployment with the fastest unemployment growth in the rural areas and especially among the age group 10 to 34 years.

[46] ERA(2005)"Country Report Tanzania" :Background paper for the study.

[47] This governs only the Tanzania mainland. Labour legislation in Zanzibar falls under separate legislation.

those in EPZs or free trade zones.

HIV-AIDS looms ominously on the Tanzanian landscape with the number of people infected by the disease estimated at some 2 million. There is a gap between unskilled labour and high skilled ones in terms of awareness of HIV-AIDS testing, although awareness is high in general. On the contrary, levels of HIV-AIDS awareness campaigns in the workplace are low. Only 31% of Tanzanian companies have some type of preventative program. Of these, half report that they provide counseling. Programs involving condom distribution, anonymous HIV testing, and financial support for dependents is far less common and found in only 13% of companies. The absence of a stronger response may attribute to the relatively small impact on their production from HIV-AIDS as of today.

3.4. Official Development Assistance (ODA)

3.4.1 Overview of assistance by donors and international organizations

Tanzania is one of the poorest countries in the world. Per capita income in 2005 is estimated to be at around US$ 330 [48] and, life expectancy at birth and infant mortality remain high. On the other hand, the country has shown a firm commitment to poverty reduction and development through the achievement of democracy, structural reforms and market-oriented economic policies, as spelled out in the PPRSP in 2000 and in the new PRSP, the National Strategy for Growth and Reduction of Poverty (NSGRP) of 2005.

From these reasons, Tanzania attracts a large amount of assistance. Donors have increasingly shifted their assistance away from financing individual projects toward more flexible forms of assistance, including sector baskets and general budget support. In addition, a variety of mechanisms have been developed to encourage greater alignment of donor assistance with the priorities outlined in the PRSP. The principles that govern the relations between donors and the Tanzanian government are specified in the Tanzania Assistance Strategy (TAS), and the adherence to the commitments of both parties is evaluated in the Consultative Group meetings by an Independent Monitoring Group (IMG), a mechanism endorsed uniquely in Tanzania. Sector programs based on the sector-wide approach (SWAPS) is especially prominent in the area of education and health.

The focus of the NSGRP is on economic growth, centered on agriculture and rural development, and on further strengthening the business environment to boost private sector-led growth and export diversification. Thus, a new surge of private sector development and investment climate improvement assistances are expected to follow from the donor community.

Below is an overview of the assistance by major donors. (See appendix for selected donors assisted projects in the private sector development sector.)

Table 3.5: Economic Cooperation towards Tanzania by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	United Kingdom 158.6	United Kingdom 88.6	Japan 217.1	United Kingdom 290.1	Holland 138.3
2nd	Germany 109.9	Denmark 80.9	United Kingdom 152.7	Japan 260.4	Italy 132.3
3rd	Japan 83.4	Japan 74.8	Holland 97.3	Holland 75.1	United Kingdom 103.2
4th	Holland 80.3	Germany 66.6	Denmark 68.8	Denmark 66.6	United States 85.4
5th	Denmark 69.6	Holland 55.2	Sweden 63.5	Germany 48.2	Belgium 70.6
Japan					

48 World Bank data.

	83.4	74.8	217.1	260.4	58.2
Total	769.2	613.4	778.7	943.8	902.8

Source: Compiled by MOFA Japan from OECD/DAC

3.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

Tanzania is ranked as a high priority country for assistance by Japan. Its assistance closely follows its Country Assistance Plan for Tanzania and the Tanzania's PRSP. It has also classified Tanzania as the most important country for aid harmonization. Through the ODA taskforce based in Tanzania, Japan has actively been participating in the sector program and plays a coordinator for the agriculture sector, in which it is the lead donor. Since 2001, Japan has been participating in the Poverty Reduction Budget Support (PRBS) which is a form of a general budget support to the Tanzanian government and since 2003, it has also been participating in several common funds.

Below is a summary of the level of recent ODA from Japan to Tanzania. Japan is emphasizing the following sectors for its assistance strategy based on the first PRSP: 1) agriculture; 2) basic education; 3) health; 4) basic infrastructure; and 5) forest conservation.
In the basic infrastructure sector, Japan has contributed 20% of all extension of paved roads, 40% of all power transmission network, 30% of telephone lines in Dar Es Salaam. Due to the new emphasis of economic growth in the new NSGRP, JICA is particularly looking to strengthen their activities in private sector development.

Table 3.6: Recent ODA to Tanzania

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-8.22	241.32	27.35	260.44
2002	-6.54	39.31	25.43	58.20
2003	-1.76	53.90	22.32	74.47
Cumulative Total	71.00	1,413.50	433.17	1,917.67

Source: Compiled by MOFA from OECD/DAC

In collaboration with UNCTAD, Japan Bank for International Cooperation (JBIC) has just completed writing the Blue Book regarding improvements on FDI climates for Tanzania, Kenya and Uganda. This book specifies six concrete Action Plans in the area of development and improvements of legal systems/institutions, strengthening of investment promotion agencies and private sector development. It also specifies recommendation of actions from the perspective of speeding up the East African Community (EAC) integration process.

(2) United Kingdom

Tanzania is DFID's largest program in Africa. Its commitment has doubled from 40 million GBP in 1997/8 to GB£80 million in 2003/4 and is set to rise to GB£110 million in 2005/6. DFID is primarily focused on direct budget support for the Tanzania government's PRSP and last year, it allocated 60 million GBP to the government in this way. In fact, the UK was the first donor to shift its sector-earmarked assistance into general budget support and has been very active in the promotion of aid harmonization. It combines technical assistance and financial assistance that supports: 1) the further development and embedding of poverty reduction processes; 2) increased and sustained economic growth, focusing on growth which is equitable and which the poor can participate; and 3) effective and accountable government.

(3) United States

USAID does not contribute to any of the sector baskets, nor does it provides assistance in the form of general budget support. Thus, USAID is often seen as an outlier among the donors. Its focuses on achieving four principal objectives which in fact do not deviate from the PRSP too much: 1) improved health; 2) better resource conservation; 3) a stronger partnership between civil society and government; 4) more vibrant private sector.

Its activities include improving product quality to meet export standards and providing training to business owners. Programs focus on Tanzania's breadbasket, introducing affordable and improved farming methods to farmers in areas proven to have significant growth potential. In addition, USAID is supporting the development of partnerships between American companies, such as Starbucks and General Mills, and Tanzanian businesses, to help them identify and penetrate new markets, create sound business plans, raise financing, and think and act strategically. Improving the tax environment for small businesses and improving the rural road are also areas that the USAID is actively involved in.

(4) World Bank

Since 1963, the World Bank has approved over US$5 billion in credits and US$243 million in grants. Currently, the portfolio comprises of 23 active projects with commitments of US$1.6 billion in all major sectors. Based on the Country Assistance Strategy (CAS) for Tanzania created in 2000, the World Bank's involvements focus on higher growth, poverty reduction, and institutional reforms to improve governance and service delivery. It has shifted its emphasis from infrastructure development towards operations with a direct bearing on poverty and social sector programs. In the areas related to investment climate improvements, a Central Transport Corridor Roads Projects (US$162 million) and an Emergency Power Supply Project (US$45 million) was approved in 2004.

APPENDIX: Selected Donor Financed PSD Activities in Tanzania

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
Canada	Micro Finance	Micro-enterprise Business Development Project	2.8 million USD	Huduma ya Maendeleo – Tanzanian NGO	1995 – 09/02	The objective of the project is to develop a local institution that will promote the role of micro-enterprise in the Tanzania economy. The project strategy is to provide loan capital for lending to micro-enterprises on a sustainable basis so as to increase their financial stability, potential for growth and employment creation.
	Micro Finance / capacity building	Micro finance Capacity Building Facility	3.3 million USD	GoT	Tentative 2002-07	To support Tanzania in poverty reduction by increasing the income generating capacity primarily of the underprivileged by strengthening the capacity of a selected number of micro finance institutions to deliver financial services to small businesses and income generating activities.
	Micro Finance / capacity building	Capacity Building for Savings and Credit Cooperative Societies	0.5 million USD	Savings and credit Cooperative Societies	06/01-03	To develop the management and technical capacities of grass root micro finance institutions to provide quality services to micro-entrepreneurs.
	Micro finance / policy formulation	Enabling environment for micro finance industry	1 million US$	GoT	2002-05	The purpose of the project is to strengthen the capacity of the Bank of Tanzania to develop a regulatory and supervisory framework for promoting the development of an efficient and effective micro finance service industry.
Denmark	Training	Vocational Education and Training Authority - VETA	8 million USD	VETA/Ministry of Labour and Youth Development	01/98 – 12/02	Support to VETA to improve vocational and educational training by making it demand oriented and receptive to the changes and demands of the private sector.
	Micro Finance	Micro Finance Component	2 million USD	CRDB	01/98 – 12/02	Pilot project to strengthen SACCOs and other MFIs to receive credit through CRDB, thus making CRDB an apex bank.
	Finance sector	CRDB Restructuring	8 million USD	CRDB	1994 - 2002	DANIDA has purchased 30% share in CRDB, and has financed technical assistance and hardware for the information system (satellite based) among other things.
	Finance sector	Venture Capital fund	3.5 million USD	FEDHA Fund	1994-2002	DANIDA has purchased 26% share in FEDHA fund, as well as 20 stake in First Capital Partners that manage said fund – Venture Capital for high growth potential companies in Tanzania
	Finance sector	Bankers' training	N/a	Tanzanian Bankers Association	2002- n/a	Establishment of a Bankers Training Institute/School
	Policy Formulation	MYLDS	0.6 million USD	MYLDS	03/01 – 12/02	Institutional support to the Labour department in Ministry of Labour and Youth Development and Sports (MYLDS)including upgrading of office. Hearing, discussing and preparing a new labour law.
	Policy formulation / legal reform	Review of insolvency law	25,0000 USD	Mkono Co. Law Firm		A review of the insolvency and bankruptcy law, as a first step in drafting a new law.
	Policy formulation / legal reform	Drafting and hearing of new insolvency law	80,000 USD	N/a	06-12/01	Drafting and hearing of new insolvency law
	Policy formulation / legal reform	Review and drafting of law on industrial design	N/a	N/a	06-12/01	Review and drafting of law on industrial design

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
	Policy formulation / legal reform	Establishment of Commercial Court	1.8 million USD (phase one)	Court of Appeal	99 02 (ph.1) 03-07 (ph.2)	Twining with Danish and Canadian commercial courts. Computer based court handling system, extensive training of professional staff
	Policy formulation / legal reform	Support to BRELA, Tanzania Bureau of Standards, Weights and Measures and Government Chemist	N/a	MIT	02-n/a	Regionalisation of the services offered, computerisation of work etc.
	Advocacy	Confederation of Tanzanian Industries (CTI)	1.5 million USD	CTI/DI	98-12/02	Twinning with Confederation of Danish Industries (DI), support to various studies and professional staff.
	Capacity building	PSD Support	N/a	N/a	Jan/01 permanent	Twinning program for joint ventures, support for studies, visits, project investment, technical assistance and environmental investment.
	Advocacy	Trade Union Movement	1.5 million USD		2001-02	Support to strengthen the Trade Union as a major player in civil society and a counter balance to the business organisations - project document under development.
Germany	SME Service Delivery	Strengthening self-help organisations in the informal economy	6.8 million USD	SIDO and other NGOs	1991 – 04/02	The target is the Small Industries Development Organisation (SIDO) to improve its capacity to deliver business development services effectively on a sustainable basis.
	SME Service Delivery	Business development services		SIDO and municipalities		The improvement of entrepreneurship and business management training delivery of three regional SIDO offices. Assistance to get additional loan funds. In addition, facilitation of local business promotion activities of the respective municipalities.
	SME Service Delivery	Support to small businesses		Hans Seidel Foundation, Small businesses and NGOs		Support to small businesses with training and consultancy services. In addition, subsidies go to non-governmental initiatives in this field.
	Financial sector	Tanzania Development Finance Company (TDFC)		TDFC		German Investment and Development Company (DEG) is a partner in the TDFC.
	Financial sector	Tanzania Venture Capital Fund (TVCF)		TVCF		German Investment and Development Company (DEG) is shareholding in TVCF.
	Fiscal	Tax Administration Programme		TRA	1998 - 2001 (next 3-yr phase agreed)	The objective is to collect income tax in a fair, effective and efficient way, and to increase revenues
	Capacity building	Joint Integrated Trade Assistance Program (JITAP)		MIT	Ends 97/02	Capacity building in relevant government bodies and private sector organisations through special training programs, to enable Tanzania to cope with the WTO agreement on liberalised markets.
	Regional integration	Support to East African Community		EAC	98-07	Enlargement of the markets available to regional firms and the subsequent increase in interregional trade flows as well as increased competition as a pre-condition for lower prices, higher standards of products and sustainable export development are in the focus of the Secretariat.

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
	Capacity building	TCCIA				Part of the Private Sector Promotion Project East Africa. The aim is to improve the service delivery and advocacy capacity of the chamber through capacity building. At a later stage, the networking with the private sector representative organisations in the other East African countries will also be a focal point of the project.
	Training	Vocational and Educational Training Authority (VETA)		VETA	Ends 97/02	To strengthen VETA's role as facilitator and coordinator in the VET system. Improvement of VETA's advisory, management and labour market analysis capacity as well as improvement cooperation with employers and other training providers. Assistance in expansion of training concept to meet the needs of target groups not yet addressed by the formal training programs.
ILO	Informal sector	Assistance to Informal Sector Associations	8000 USD	VIBINDO - FISOTA	01-02/01	Assistance to strengthening VIBINDO SOCIETY, an informal sector organisation in Dar es Salaam. Assistance to the creation/inauguration of FISOTA, Federation of Informal Sector Organisations in Tanzania.
	SME service delivery	Start and Improve Your Business (SIYB)		Private trainers/consultants and training institutions (IFM, SIDO, MEDA, ZAD, OICT)	01 /98 - ongoing	Training of trainers program in different training modules: 'Generate Your Business Idea', 'Start Your Business', and 'Improve Your Business'.
	SME service delivery	environmentally sustainable urban development	0.2 million USD	Local training institutions	01/97-03/01	Training of small and medium enterprises in waste handling, business management, marketing, occupational safety and health etc.
	Bridging the gap		25 000 USD	Eastern Southern African Management Institute (ESAMI), Arusha	2001 - 04	Strengthening capacities of non-bank financial intermediaries to set up, operate, expand and monitor guarantee funds. A programme in support of non-bank financial institutions managing guarantee funds for small and micro-enterprises
						A qualitative analysis of constraints and coping mechanisms of micro-enterprises in Tanzania. Research study on regulatory and non-regulatory constraints faced by micro-entrepreneurs, and analysis of how they deal with these constraints.
	Policy formulation / informal sector	Informal Sector Roadmap	85000 USD	Enterprise Development Centre (EDC)	06/01 – 04/02	Research study on regulatory and non-regulatory constraints faced by micro-entrepreneurs, and analysis of how they deal with these constraints.
	Micro /small scale enterprises	Micro /small scale enterprises	22,151 USD	Economic and Social Research Foundation (ESRF)	02-10/01	A review of policy, legal and regulatory framework and its impact on employment International comparative research project on the impact of policy and regulation on employment in SMEs.
Netherlands	Capacity building	FAIDA Small Enterprises Promotion	1 million USD	Farmers and business development service providers	07/99-06/02	Facilitation of the establishment of market linkages for farmers.
	Capacity building	PSD Lake Zone	1 million USD		01/00 – 12/02	Facilitating advocacy, business development services and training.

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
	Financial services	FAIDA Small Enterprises Promotion		SMEs through CRDB	07/99 – 06/92	Guarantee scheme jointly with CRDB for lending to SMEs.
	Financial services	Financial sector development			2002	Facilitate the accessibility of financial services to the rural poor.
	Financial services	Smallholder Dairy Support Programme (SDSP)	4,3 million USD	Small dairy farmers	2001-05	Provides credit in kind (heifers) to small holders farmers.
	Financial services	Equity Participation		ACB		Provides equity funds to Akiba Commercial Bank and Venture Capital
	Policy formulation	BEST			2002	To improve the business environment.
	SME service delivery	TCCIA branches in districts	USD 650 000	Business services providers	07/99 – 06/02	Organising business groups in order to increase their lobby power in districts.
	Linkages	PMOA	4 million USD	Tanzanian / Dutch firms	2000-02	Promotion of Dutch investment in Tanzania by linking up with Tanzanian firms.
Sweden	Capacity building	Promotion of Rural Initiatives for Micro Enterprises (PRIME)			2001-03	Establishment of market linkages between markets and farmers
	Micro Finance	Promotion of Rural Initiative and Development Enterprises (PRIDE)	0.4 million USD	PRIDE	2000-02	Institutional support is provided for research and development activities to further improve on the PRIDE micro-finance model.
	Financial sector	Bank of Tanzania (BOT)		BOT		Assistance is provided to the BOT Task Force on the review of the legal, regulatory and supervisory framework for micro-finance in Tanzania.
	Financial sector	Capital Markets & Securities Authority (CMSA)	800 000 USD	Capital Markets & Securities Authority (CMSA)	1996-2002	Support is provided to enable the authority to develop its regulatory and supervisory capacity and strengthen and develop the newly established Dar es Salaam Stock Exchange (DSE).
	Financial sector	Tanzania Venture Capital Fund (TVCF) and Fedha Fund	Until now 800,000 USD	Tanzania Venture Capital Fund (TVCF) and Fedha Fund	From 1997	Support is provided in the form of conditional loans to Swedfund International AB, which is owner of the Swedish shares in the two funds. Both TVCF and Feda Fund make investments in industrial ventures in Tanzania.
	Financial sector	Financial Sector Assessment	250,000 USD	Tanzania Venture Capital Fund (TVCF) and Fedha Fund	2001	The outcome will provide guidelines and directions for additional Swedish interventions in support of financial sector development in Tanzania during the coming years.
	Policy formulation	National Trade Policy	200 000 USD	MIT	2000-02	Support to the formulation of the national trade policy
	Capacity Building	Capacity Building Project for MIT	750 000 USD	MIT	2000-03	The capacity building project consists of the following three projects: 1. Implementation of competition policy and law; 2. Reduce business transaction costs, and; 3. Upgrading of the Ministry's registry function.
	Capacity Building	Tanzania Bureau of Standards (TBS)	0.3 million USD	Tanzania Bureau of Standards (TBS)	2000-02	Capacity Building

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
	See main report.	Business Environment Strengthening for Tanzania (BEST)		See main report.	2001-04	See main report.
	Advocacy	TCCIA support	1.5 million USD	TCCIA	96 – 03; probably 3-yr ext.	Development of TCCIA into a sustainable and member-driven chamber network, able to provide appropriate services and authorities to the business community.
	Linkages	Enterprise Development Programme (EDP)				Assistance is given to facilitate and support the development of commercial relationships between Swedish and Tanzanian companies.
UNDP	Micro finance	Micro Save Africa	660,000 USD		98 - 01	Assistance to organisations for strengthening their ability to enhance saving service development. The micro-finance team will provide technical advisory input to AFCAP on savings related issues, providing technical advisory input to MFIs and take forward the UNDP Africa Regional Savings Mobilisation Initiative (ARSMI).
UNIDO	Training	Integrated Training Programme for Women Entrepreneurship Development	620,000 USD	Ministry of Industry and Trade/SIDO		Entrepreneurship development programme targeting women involved in micro-scale food processing activities.
	SME Service delivery	Small and Medium Enterprises Development	71,500 USD	MIT		Strengthening capacity of Ministry of Industry and Trade for SME promotion and policy formulation.
	Policy formulation	Strengthening capacity of Ministry of Industry and Trade for SME promotion and policy formulation.	163,500 USD	MIT		Investment promotion strategy, revising of Act, regulatory and institutional environment.
	Policy formulation	Assistance in Implementation of Sustainable Industrial Policy (SIDP)	182,000 USD	MIT		Strategy and plan of action for implementation of SIDP, industrial partnership and consultative mechanism between public and private sector.
	Advocacy	Tanzania Private Sector Foundation (TPSF), Confederation of Tanzania Industries (CTI) and Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA)	630,831 USD	Tanzania Private Sector Foundation (TPSF), Confederation of Tanzania Industries (CTI) and Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA)		Description Improving capacities in private sector institutions, improving dialogue between government and private Sector.
United Kingd	SME service delivery	Small Enterprise Development Agency (SEDA)	1.4 million USD	SEDA	99-02	Assistance to build up institutional capacity to transform and manage itself as a sustainable provider of financial services to micro entrepreneurs, particularly women.

Donor	Area	Project or Program	Amount	Recipient	Start/end date	Description / objective
	Micro finance	FINCA	2.2 million USD	FINCA	99-04	FINCA will provide credit and savings services to low-income entrepreneurs primarily women with a view of increasing their income and improve their standards of living. The approach will be to work through an expanding Village Banking Network saved by a sustainable financial intermediary, FINCA, Tanzania.
	Micro finance	AFCAP	6.6 million USD		99-02	AFCAP is a micro-finance capacity building programme in Africa aimed at enhancing the capacity of micro finance institutions to deliver financial services to poor people on a sustainable and replicable basis.
	Micro finance		660,000 USD		98-01	Assistance to organisations for strengthening their ability to enhance saving service development. The micro-finance team will provide technical advisory input to AFCAP on savings related issues, providing technical advisory input to MFIs and take forward the UNDP Africa Regional Savings Mobilisation Initiative (ARSMI).
USA	Capacity building	Private Enterprise Support Activities			09/01 – 09/05	Market linkage and information development, business skills training.
USA	Fiscal	Tax and mining policy	1,330,000 USD		06/01 – 09/03	Policies to support artisanal mining and the optimal investment of Government income from the mining sector.
USA	Policy formulation	06/01 – 09/03			06/01 – 09/03	Capacity building for Policy Analysis Department of the Ministry of Finance.
USA	Policy formulation / capacity building	Private Enterprise Support Activities		TRA, BRELA, CSD, TIC, etc.	06/01 – 09/05	Capacity building and "Quick Wins" in selected Government of Tanzania agencies.
USA	Advocacy	Tanzania Private Sector Foundation (TPSF)	95,000 USD	TPSF	10/00 – 06/01	Start-up operational support.
World Bank	Micro finance	Rural and micro-financial services project	2 million USD	Bank of Tanzania	2000-02	
World Bank	Financial sector / micro finance	Second Financial Institutions Development Project	27 million USD	Bank of Tanzania/ National Micro-finance Bank	2000-03	

Source: NORAD (2002), Study on Private Sector Development in Tanzania

4. MADAGASCAR

4.1. Trends of Macro Economy, Industry, Trade and Industry

4.1.1 Macro Economy

In the mid 1990s Madagascar abandoned their socialistic economic policy and began liberalization of the economy with private development policies under the guidance of the World Bank and IMF. Since then, the nation has overcome the stagnated economy for the long time and has moved into a period of gradual, stable growth. The vital component of the economy is the agriculture, forestry and fishing industries, accounting for one-quarter of the GDP yield and involving nearly 80% of the active labour forces. As a result of free access to the US markets in recent years through the African Growth and Opportunity Act (AGOA), exports of textiles and clothing have been flourishing. However, there has been less growth in the domestic private sector and less foreign direct investment (FDI) than expected, as a result of long years of government intervention in the economy, as well as political instability between the end of 2001 through the following year. Although the country possesses abundant and unique plant and animal species that are a valuable tourism resource, there is a high level of dependence on charcoal and wood as a source of energy for the citizens, particularly in the farming villages, so dealing with the problems of deforestation and the soil erosion that is caused is an issue.

In 2002 the current president Marc Ravalomanana was formally sworn into office. He is currently searching for measures to achieve rapid and sustainable economic growth, and overcome the effects of the political crisis of 2001- 2002 in which GDP dropped by 12%. Over the next few years, the main focus is likely to be on reducing poverty through the development of rural areas and development of infrastructure, as well as the eradication of corruption to ensure the administrative effectiveness. The Madagascar economy suffered tremendous damage in early 2004 as a result of cyclones in addition to rising inflation due to sudden price increases in international markets for petroleum and rice imports. On the macroeconomic level, a high growth rate of 5.3% was recorded for 2004, with price for basic commodities, starting with the staple food rice and petroleum products, continuing to climb, so the domestic business circumstances improvement is not apparent. In the 2005 fiscal year the rate of economic growth is expected to be around 6%, but unless some policies remain to be put forward that the citizens expect hopefully will lead to positive results in the near future, there is possibility that the new government will lose its momentum gradually.

According to the IMF the main policy issues of the Madagascar government are the restoration of financial regulation and improvement of governance, the strengthening the private sector, including support for entrepreneurs, the promotion of exports and investment, and continuing the structural reforms to develop the environment needed to support these activities. According to the 6th review of the IMF based on the “Poverty Reduction and Growth Facility (PRGF) 3 Year Plan” the government has set an inflation target of 5.5% or less for the 2005 fiscal year, and financial regulations are being tightened. The annual budget is limited to only small increases in the operating expenditures and includes an expanded investment budget incorporating foreign fund procurement and the investment attraction capability of the Madagascar economy, with the hope of covering the increases in the annual expenditure through increases in tax revenues as a result of enhancements to the tax collection system. Government authorities are also emphasizing an expansion of the financing system to the private sector.

With regard to monetary policy, since January 1, 2005 the Madagascar Franc (FMg) has been replaced by the Ariary as the local currency. The new currency was exchanged at a fixed rate for the old currency (1 new Ariary = 5 old Madagascar francs). As a result, it is claimed that there has been no effect on exchange rates, but, in fact, many citizens are struggling to adapt themselves to the new system. As apparent from the introduction of the Euro in Europe, for a period of several years after the currency switch, many of the citizens will continue to naturally calculate prices and costs in the old currency. The FMg was valid currency until the end of November 2004, but is actually still being used in parallel to the new currency. The Central Bank plans to accept notes for exchange until December 31, 2009.

According to the 2002~2004 “Madagascar Country Strategy Paper” of the World Bank, the major economic reforms implemented from 1994 to 2001 are (1) Introduction of a Value Added Tax (VAT), (2) Tax exemption limitations, (3) Complete abolition of export duties, (4) Reduction of tariffs on capital goods from 20~30% to 10~20%, (5) Increasing the unit tax rate and the consumption tax rate for petroleum products as a complementary measure to other measures described above, (6) Reduction of income tax rates, (7) Introduction of compound tax, (8) Creation of a Major Enterprises Service to collect taxes from businesses with annual sales in excess of 250,000,000 FMg, (9) Establishment of the Bureau for the Domiciliation of Tax Waivers Systems to monitor enterprises in the EPZ, (10) Establishment of the taxpayer identification number system (NIF) needed to monitor taxpayers, and (11) Abolition of the Madagascar Tax Monopoly Office managing the separate taxes for alcohol, tobacco, matches and wheat flour.

For public expenditures the main issues are (1) Implementation of an annual common review, (2) Focus on public investment in priority sectors like enhancement of infrastructure, education, medicine, and security measures, (3) Reduction of the number of PIP projects from 600 to 375, and (4) Creation of process management charts (contract based and funding based) for each project.

The necessary measures for monetary policy are (1) Introduction of floating exchange rate system, (2) Raising interest rates, (3) Creation of a foreign exchange market between banks to develop exchange rate determination mechanisms to handle market supply and demand, (4) Establishment / introduction of a new monetary agency and new monetary products based on the 1995 New Bank Law stipulating regulations on the banking industry and strengthening the bank supervision system, and (5) Indirect control and regulation from the Central Bank. Specifically, increasing the conversion rate for mandatory deposits to 20%, creating a monetary market in which the private banks can freely set interest based on the standard rates of the Central Bank, and introducing a short-term national debt to mobilize financial resources for banks and non-banks.

The issues related to exchange rate policies and trade are (1) Complete abolition of restrictions on payments and transfers, (2) Acceptance of IMF Article 8, and (3) Abolition of export taxes and what are called non-tariff barriers on foreign transactions (excluding negative lists intended to manage public health and safety).

With regard to price controls it is necessary to (1) Abolish price controls on wheat flour, (2) Eliminate government intervention in the rice market, and (3) Periodically adjust prices of petroleum products with consideration of international prices and exchange rates.

Reduction of government intervention in economic sectors includes (1) Abolition of monopoly system of public companies, (2) Adoption of privatization laws, (3) Establishment of a privatization council, (4) Practical liberalization of the telecommunications sector to the private investors, (5) Partial liberalization of aviation transportation (only international routes), and (6) Privatization of 2 government-operating banks.

In addition to the main policy issues mentioned above, there are several other reform goals. Specifically, (1) Public service sector (investigate number of public employees, monitor the 6 ministries (Ministry of Education, Ministry of Health, Ministry of Justice, Ministry of Pubic Works, Ministry of Finance, Ministry of Budget) established on a trial basis, and revision of the status of public employees), (2) Liberalization of the agricultural sector (Vanilla project), (3) Investment promotion measures, such as easing of land laws extending 99 year leases, liberalization of employment of foreign skilled labour, abolition of departure visas for foreigners, revision of commercial law, and the establishment of funds to buy and sell stock in public businesses, and (4) Decentralization of authority (creation of autonomous regions and gradual shift of administrative authority to them).

The speed of the reform towards the “rapid and sustainable economic growth” called for by president Ravalomanana regime has been rapid, with many of the “reform foci” mentioned above already implemented, or already in the implementation phase. However, it is apparent that the various ministries and agencies, local governments and the citizens themselves are not always keeping pace with so called ‘’top down reforms’’. The reforms don’t always seek the results in visible way, so there is still room for future anxiety and dissatisfaction among the people.

Table 4.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	6.2	7.9	10.3	13.6	14.6	15.1	15.5	16.0	16.4	16.9
Population ages 0-14 (% of total)	44.8	45.1	43.0	44.7	45.3	45.2	45.2	44.8	44.4	44.0
Population ages 15-64 (% of total)	52.5	51.6	53.4	52.3	51.7	51.8	51.8	52.2	52.6	52.9
Population ages 65 and above (% of total)	2.7	3.3	3.6	3.0	3.0	3.0	3.0	3.0	3.0	3.0
GDP (constant million 2000 US$)	2,367.9	2,901.5	2,931.5	3,348.8	3,536.7	3,701.4	3,877.6	4,110.3	3,588.1	3,939.4
GDP growth (annual %)	3.0	1.1	0.6	1.8	3.9	4.7	4.8	6.0	-12.7	9.8
GDP per capita (constant 2000 US$)	382.9	367.4	285.0	246.7	242.4	245.9	249.8	257.3	218.3	233.2
Official exchange rate (LCU per US$, period average)	251.2	234.1	854.1	4,059.1	5,441.4	6,283.8	6,767.5	6,588.5	6,832.0	6,191.6
Inflation, consumer prices (annual %)	2.6	9.4	17.9	17.4	6.2	9.9	12.0	6.9	15.9	-1.2
Money and quasi money (M2) as % of GDP	15.7	18.0	15.5	18.9	18.6	18.3	19.3	20.5	23.4	22.5
Real interest rate (%)	-	-	11.0	10.4	17.1	16.7	18.0	16.7	8.6	20.9
Foreign direct investment, net inflows (% of GDP)	0.9	0.2	0.2	0.7	0.4	1.6	2.1	2.1	0.2	0.2
Foreign direct investment, net inflows (% of gross capital formation)	9.1	2.3	1.9	5.4	3.0	10.5	14.2	11.1	1.3	1.3
Agriculture, value added (% of GDP)	24.6	30.3	34.1	28.6	30.6	30.0	29.1	28.6	31.7	29.2
Industry, value added (% of GDP)	15.0	16.7	13.5	12.3	13.6	13.8	14.5	14.7	14.4	15.4
Manufacturing, value added (% of GDP)	-	-	11.3	10.4	11.6	11.7	12.3	12.5	12.5	13.7
Services, etc., value added (% of GDP)	60.5	53.1	52.4	59.0	55.8	56.2	56.4	56.7	53.9	55.4
General government final consumption expenditure (% of GDP)	15.6	12.1	9.4	7.8	7.8	7.2	6.8	8.3	8.2	9.2
Household final consumption expenditure, etc. (% of GDP)	81.6	84.6	86.9	87.8	85.1	85.6	85.5	76.4	84.1	83.0
Final consumption expenditure (% of GDP)	97.2	96.7	96.4	95.6	93.0	92.8	92.3	84.7	92.3	92.2
Gross capital formation (% of GDP)	8.0	10.3	10.8	12.2	14.8	14.9	15.0	18.5	14.3	17.9
Exports of goods and services (% of GDP)	15.7	15.1	13.9	21.5	21.5	24.5	30.7	29.1	16.0	21.5
Imports of goods and services (% of GDP)	21.0	22.1	21.1	29.3	29.3	32.2	38.0	32.3	22.6	31.6
Gross domestic savings (% of GDP)	2.8	3.3	3.6	4.4	7.0	7.2	7.7	15.3	7.7	7.8
Gross capital formation (% of GDP)	8.0	10.3	10.8	12.2	14.8	14.9	15.0	18.5	14.3	17.9
Food exports (% of merchandise exports)	78.8	77.8	78.1	57.0	42.1	35.9	32.8	48.7	61.1	55.5
Food imports (% of merchandise imports)	13.8	15.3	14.5	13.9	14.4	13.7	13.8	13.3	14.2	16.3
Agricultural raw materials exports (% of merchandise exports)	9.4	4.7	3.3	5.1	6.5	6.1	3.4	3.7	3.5	3.6
Agricultural raw materials imports (% of merchandise imports)	1.2	2.0	2.2	1.2	1.1	0.6	0.4	0.8	0.2	0.5
Ores and metals exports (% of merchandise exports)	3.9	4.7	4.8	6.5	7.2	3.8	1.8	1.2	2.0	1.5
Ores and metals imports (% of merchandise imports)	0.8	1.0	0.7	0.5	0.5	0.5	0.3	0.6	0.6	0.5
Fuel exports (% of merchandise exports)	1.7	5.6	4.5	2.5	4.2	2.4	3.3	1.5	2.1	0.4
Fuel imports (% of merchandise imports)	6.0	14.3	20.1	19.5	18.7	24.2	23.4	23.7	38.7	10.2
Manufactures exports (% of merchandise exports)	6.2	7.1	9.2	26.9	36.2	49.8	58.2	43.9	30.5	38.4
Manufactures imports (% of merchandise imports)	78.1	67.2	62.2	63.7	63.3	60.2	61.7	60.8	45.8	71.9
Aid per capita (current US$)	5.3	10.8	25.7	30.5	33.0	23.8	20.8	23.4	22.7	31.9
Total debt service (% of exports of goods and services)	-	17.1	40.7	16.1	14.7	17.1	9.6	5.2	8.7	6.1
Total reserves in months of imports	-	1.0	1.7	1.7	1.7	2.2	2.2	3.0	4.0	2.8

The World Bank (2005), *World Development Indicators: 2005*

4.1.2 Industry

Madagascar is situated off the coast of East Africa, and is the largest island nation in the world (1.6 times the area of Japan). As a result of the history and geography, the population is composed of a variety of ethnic groups, including Malay, African, Arab, Chinese, Indian etc. In addition to being entirely surrounded by ocean, the island is blessed with abundant rainfall and a great variety of vegetation. More than 75% of the active labour population is employed in the agriculture and fishing industries, which are the key industries of the country. Even after the independence, there continued to be economic ties with their former colonial power, France. As a result of the adoption of socialistic economic policies, the economy stagnated and income levels remained low. Since the mid 1990s, however, as a result of the introduction of economic liberalization policies, there has been an increase in new foreign direct investment (FDI) as well as diversification in the non-agricultural sectors. Except for the period of political crisis in 2001- 2002, the Madagascar economy has continued on a path of steady growth. After joining the Common Market for Eastern and Southern Africa (COMESA), Madagascar also joined the Southern African Development Community (SADC). New positive effect are expected, such as improved access to Southern African markets, the largest in the sub-Saharan region, and new FDI from the South African business community that is the core of the SADC regional economy.

Comparing the proportion of the GDP for component sectors in FY2003 to that in 1990 shows that agriculture, forestry and fishing have not changed, with 29%, while mining and industry has grown from 13% to 15%, mainly in manufacturing, and the service has declined from 59% to 55%. Although there have been no apparent major changes in the industrial makeup, based on the economic growth since 1990 an overall improvement trend can be seen.

Agriculture is primarily focused on the production of rice, taking advantage of the abundant ground water and fertile soil to produce 2.8 million tons of rice annually. The majority of this is consumed domestically, but the nation is not completely self-sufficient due to old-fashioned distribution system, a faster growing population and relatively low productivity. Other agricultural food products include cassava, yams and potatoes. Cash crops for export are represented by vanilla, for which Madagascar is world renowned as a top producer (4,000 tons annually). Other export crops are cloves, coffee beans, and litchi. Repeated incursions by cyclones are a menace to the nation's agriculture industry. In the fishing industry traditional methods are broadly used, but production scale and export values of various types of fish on commercial bases, such as frozen shrimp, prawns, squid, and octopus are increasing. Nevertheless, the annual catches are only about 110,000 tons thus far, so there is still room for increased production.

Manufacturing sub sector accounts for more than 90% of the mining and industry. One-third of the total production of the entire manufacturing industry is from Export Processing Zone (EPZ) status companies. EPZ companies created employment for 110,000 people in 2003, and accounted for 30% of the total export value. Non-EPZ companies produce goods mainly for domestic consumption, such as foods, beverages, tobacco, textile products, pharmaceuticals, electronic goods, and construction materials. In contrast, the EPZ status companies concentrate on textiles and clothing, processed foods (marine products), information services, and lumber processing; receiving FDI from companies in France, Mauritius, other Europe and various Asian countries. The textiles and clothing sector in particular has been developing rapidly as a result of exports to the USA under the African Growth and Opportunity Act (AGOA). Wage levels in Madagascar are relatively low, even by regional average, so there are more than a few companies shifting from Mauritius to Madagascar. In the mining sector there are many kind of untouched mineral resources, including titanium, gemstones, rare metals, and nickel. Restrictions on foreign capital access to the sector are lifted, and it is sure that there will be a series of large new development projects in the coming years.

In the service industry investment from Europe, South Africa and Asia is promoting public utility companies in electricity, transportation, water, and telecommunications as markets open and industries become privatized. It is anticipated that improving the efficiency of these business operators will vitalize the domestic industry and reduce service costs. If there can also be progress on the development of the infrastructure for the tourism industry, results can be expected in the near future. In addition to marine resorts, Madagascar also offers a wealth of unique and varied plants and animals, making it an attractive destination for eco-tourism. In 1990 only 50,000 tourists visited Madagascar. In 2004 there were more than 200,000, with tourism revenues estimated to be in excess of $100 million USD.

4.1.3 Trade and Investment

(1) Trade

From 1998 to 2001 Madagascar has diligently increased exports, taking advantage of the preferential position as a US AGOA partner nation (since 2000). In addition to traditional products like vanilla, cloves, litchi, coffee, and marine products, there have also been increases in the exports of manufactured goods, primarily textiles. As a result, the USA has become the second largest trading partner nation, at nearly the same level as France.

As a result of concerns about the political and economic situation, there was a drastic decrease in exports in 2002, but in 2003 the amounts bounced back to exceed the previous year's levels, and have remained strong since 2004.

Table 4.2: Trade tendency and main partners

（US$ million）

		1998	1999	2000	2001	2002
Export		805	909	1,190	1,317	704
Import		1,095	1,197	1,474	1,463	993
Main trading partners						
Export	France	101.45	83.48	262.99	280.10	283.09
	United States	14.08	11.89	142.10	259.18	205.00
	Germany	10.58	14.14	27.20	59.90	49.10
Import	France	122.04	101.64	108.06	275.18	184.63
	Bahrain	1.42	0.32	84.15	92.56	100.46
	Iran	36.39	0.64	103.22	111.37	118.42

Source：World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

The amount of FDI increased from $58 million USD in 1999 to $84 million USD in 2001. A political crisis from the end of 2001 through the following year, however, caused a significant drop in FDI, down to $8 million USD, and the level in 2004 is still only half of the peak level.

Table 4.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
16.1	58.4	69.1	83.5	8.3	50.0

Source: UNCTAD, FDI On-line.

France is Madagascar's largest foreign direct investor, accounting for 44% of the total (flow, 2004). Originally, FDI to Madagascar was mainly from France and Mauritius, but in recent years investment from Hong Kong and Asia is notable in the textiles industry, which has become vitalized by USA-AGOA activity. Looking at the new investment fields by industry reveals that two-thirds of the total is accounted for by real estate, retail & trade, manufacturing such as lumber, and marine products processing and textiles that are the focus of the Economic Processing Zones (EPZ). Most recently there have been increases in FDI to the construction industry in anticipation of the large-scale infrastructure development plans being advanced by the government, and in the mining sector that is sitting on enormous, undeveloped mineral resources.

Stock of Foreign Direct Investment by Countries / Regions (100 million FMg)

	2002	2003	2004
France	5,530	7,050	8,330
Mauritius	2,310	3,200	3,970
Hong Kong	30	110	1,530
Luxembourg	1,040	1,230	1,170

Switzerland	480	750	770
Total	10,650	13,850	17,570

Banque Central de Madagascar, rearranged by JETRO

Stock of Foreign Direct Investment by economic sectors （100 million FMg）

	2002	2003	2004
Construction & Public works	1,510	2,900	4,280
Commerce & Trade	2,370	2,400	2,880
Manufacturing	1,410	1,070	1,680
Financial services	1,530	1,370	1,570
Mining	250	820	1,130
Total	10,650	13,850	17,570

Banque Central de Madagascar, rearranged by JETRO

It was not possible to obtain information on the individual FDI projects since 2002 from available materials opened in public. Nor was information disclosed by GUIDE, which acts as an single window for new investment project. According to information from interested persons at the local ministries and agencies, there seem to be plans for large new investments from France in hotels and agriculture, from Mauritius in textiles, from China in cement, from Europe and America in petroleum, and from Japan, South Africa and Canada in the mining sector.

Major investment projects in Madagascar that could be noted from available UNCTAD data are listed below.

Company	Home Economy	Industry	Sales (US$ million)	Employment	Year of establishment
Shell Exploration and Development Madagascar BV	Netherlands	Oil & Gas Exploration	4 286.1	66	N/A
BFV Sociètè Gènèrale	France	Commercial Banks	8.7	800	1997
Hoechst Madagascar SA	France	Chemicals	7.7	69	1969
Floreal Madagascar SA	Mauritius	Knitting Mills	7.0	4,100	N/A
Cimelta Madagascar SA	Ireland	Non-residential construction	4.7	600	N/A
Landis Madagascar SA	Germany	Vehicle supplies and new parts	4.1	95	N/A
Madagascar Daiho Corp SA	Japan	Construction	2.5	5	1996
NCS International SA	Mauritius	General Clothing Male	1.5	2,300	N/A
Fimapila SARL	France	Vehicle supplies and new parts	1.2	20	1997
BNI Crèdit Lyonnais Madagascar SA	France	Commercial Banks	N/A	1,200	N/A
Sociètè Malgache de Pècherie	Japan	Fishing	N/A	1,031	1966
Sociètè Des Cigarettes Melia De Madagascar	France	Cigarettes	N/A	427	N/A
Madagascar Hilton SARL	Britain	Hotel and Motels	N/A	234	N/A
Sociètè Industrielle	France	Storage Batteries	N/A	220	N/A

Des Produits Electriques Et Dèruvès					
Polo Garments Majunga SA	Belgium	Textiles	N/A	200	N/A
Banque SBM Madagascar SA	Hong Kong, China	Commercial Banks	N/A	93	1998
Soval Madagascar	France	Hardware	N/A	9	N/A

Source:UNCTAD

4.2. Policy Issues Promoting FDI

4.2.1 Industrial Policies and Development Plans

The Madagascar government is working on the vitalization of the private sector, including the introduction of foreign capital, preparation of the necessary infrastructure to improve the business environment, improving the quantity and quality of primary and secondary education to ensure the necessary human resources, modernization of the legal system and reduction of government intervention.

Looking at the important policies by sector, for agriculture there is development of basic social and economic infrastructure, reform of the regulations on land ownership, and improvement of loan requirements. In the fishing industry there are efforts to increase added value, including improving production and processing efficiency. For the mining industry the goal is to promote private development investment, making efforts at the same time to enhance education of the necessary human resources and reform of business-friendly laws. Furthermore, to strengthen the manufacturing industry there is work to achieve improved access to regional and international markets, EPZ reactivation, and preparation of the business environment, including development of the electric and telecommunications infrastructure and expansion of financing schemes to private business. For the tourism industry the focus is on achieving a balance between environmental preservation and rural development, while also preparing the required infrastructure, such as airports, roads and accommodation facilities.

4.2.2 FDI Promoting Policies

In 2004 President Ravalomanana opened the door to increased foreign investment and clearly stated the intent to strengthen the foundation for foreign economic relations, focusing on protection and security for investors. The base of domestic industry in Madagascar is not very robust, somewhat lacking in competitive capability and lagging in diversification. As a result, new investment of foreign capital is indispensable. The government is working on a series of investment promotion measures, such as preferential tax measures and approvals for land use (leases) for foreigners. Key fields for attracting FDI are (1) social and economic infrastructure, including telecommunications, (2) tourism, (3) textiles, (4) mining, (5) agriculture and fishing, food processing, (6) handicrafts, and (7) IT.

According to the Madagascar government the following 10 items are suitable justification for investment in Madagascar.

- Unification of local markets (SADC, COMESA, IOC) and favourable access to foreign market (US through AGOA, EU trough Cotonou Convention)
- Assured political stability
- Economic (market) growth exceeding the population growth rate
- Increase in and effective use of foreign financial aid
- Standardization of tax and tariff policies

- Good relationships between government, private sector and labor
- Abundant, diverse natural resources and cheap, quality human resources
- An adequately developed private financial sector
- Progress on local autonomy (= expansion of local business opportunities)

(1) Restrictions or Special Provisions

Since the President Ravalomanana administration took office, Madagascar has been working at a rapid pitch to prepare an investment environment to attract FDI and there are no large obstructions to new company launches. The focus on the two investment sectors of manufacturing and mining, which form the base in the EPZ, is noteworthy. For the establishment, operation and expansion of business there are no special requirements to enjoy tax benefits and other preferential measures. There are no legal requirements such as exchange regulations related to exports or obligations for export (EPZ companies are to export 100%) or local procurement above a specific level. Investors are not required to disclose information on company ownership to the government as part of the investment approval process.

1) Mining

Operators in this sector are governed by the *Mining Code of 1999*, which provides for appeals to international arbitration in the event of a dispute between investors and the state. Investments over US$120 million receive the additional comfort contained in the Law on Large Mining Investments of 2002, offering advantages such as:

- A simplified and reduced fiscal framework,
- A reduction in the royalty payable on added value operations,
- A simplified import regime for all equipment and materials for the project,
- Free movement of foreign currency in offshore accounts.
- Priority for external, hard currency debt repayments, and
- Government investment guarantees.

2) Penalties

Foreigners who wish to purchase land are expected to contribute to the national development of Madagascar, and are expected to invest US$500 000 as well as produce an investment plan, before they will be allowed to purchase the land. Should they be unable to meet these conditions during the two-year period under which the authorization to purchase the land is valid, the foreigners forsake their right to own the land and it will be repossessed by the government.

(2) Environmental Issues

Madagascar makes an effort to ensure that its unique environment survives for future generations. The most important law for foreign investors is the Dècret Mècier, which was updated in 2004. This law stipulates how any investment must attempt to align itself with the environmental priorities of Madagascar. The law is a guideline for best practice, and is not intended to stifle investment or development.
Other current environmental issues in Madagascar include the following:

- Soil erosion, as a result of deforestation and overgrazing,
- Desertification,
- Contamination of surface water, as a result of contact with raw sewage and other organic wastes,
- Deforestation, as a consequence of slash and burn agriculture, and
- Threats to bio-diversity, in particular, endangerment of several species of flora and fauna unique to the island.

4.3. Incentives and Impediments for/to FDI

4.3.1 FDI Promoting Regimes

(1) Investment Promotion Agency (Espace Promotion des Investissements: EPI)

In 1996, government created the Investment Promotion Space (EPI) within the Ministry of Industry to assist foreign investors with administrative formalities, information requests and work permit procedures.

The EPI aims to:

- Act in favour of investments.
- Make contacts and bargaining easier between foreign investors and local promoters.
- Provide assistance with administrative processes and access to information regarding the establishment of a company.
- Facilitate negotiations and terms for setting up industrial firms.
- Assist investors in shaping up their projects.
- Advise and guide investors in making strategic choices regarding the modes of finance and technological guidance.
- Help investors to seek prospective joint venture partners.

Under the authority of the Ministry of Private Sector Development and Privatization, the business-facilitating centre (CFCE) provides administrative information to people who want to set up a business. The CFCE provides entrepreneurs with the necessary documents and helps them to make their applications.

Recently, these investment promoting agencies seem to have been integrated into the GUIDE (Guichet Unique des Investissements et de Développement des Entreprises). The GUIDE, as one stop shop for investors, provides various services including:

- Formation of the appropriate legal entity under Malagasy Law
- Acquisition of staying visa and work permit
- Documentation of various application for starting up business, including Export Free Status and land acquisition
- Follow up service after business started

(2) Export Processing Zones

The Export Processing Zones (EPZ) in Madagascar are called “Zone Franche” in French. The unique characteristic of the Madagascar EPZ is that they are not industrial parks situated in specific areas. Instead, it is a status with a variety of preferential measures that is granted on the condition that 100% of production is exported. This means that companies anywhere within the country can obtain EPZ status. Practically, however, 90% of the EPZ businesses are situated in the capital city of Antananarivo, which offers easy contact with the central government and has the country’s largest markets.

As of July 2005, 102 of the 180 export companies in the country were members of the EPZ entrepreneurs association (GEEP), and are working on policy discussions and lobbying activities to the government, Promotion of EPZ and creation of business opportunities for the member companies. The preferential measures available to companies with EPZ status include tax exemptions on corporate taxes for the first 5 years of operation and on required machinery and materials, as well as a reduction of VAT. Even after 5 years has elapsed, one-third to one-half of the tax preference measures continues to be applied in comparison to the domestic favored-businesses. Regarding the VAT, based on the 1999 revision of the law under the adopted system, a 20% tax is paid initially, and returned in exchange for proof of export of all products. The purpose of this is to prevent EPZ companies from entering the local markets.

(3) Free Trade Zones

Thanks to the MFA, Madagascar was able to develop its free zone, centred on textiles and clothing production, and those production has benefited from the US AGOA.

Operators in the textile, garments and apparel sector find several incentives to locate in Madagascar, including:

- Duty and tax free import of all equipment and material,
- No withholding tax on repatriation of dividends,
- Listing as a preferential country under the US AGOA, and
- Exemption from certain provisions of the Employment Code, giving increased flexibility to respond to demand changes.

More generally, companies are exempted from company profit tax (IBS) for 5 to 10 years according to their sector of activity, from business tax and from indirect taxes, such as customs duties and VAT on equipment, under this free zone regime. In order to benefit from this regime, production activities on an enterprise need to be geared exclusively towards exports. The categories of enterprises eligible for the industrial free zone regime are:

- Enterprises active in the fields of construction and establishment of industrial free zones, including management and promotions of such activities;
- Manufacturing and processing industries;
- Service enterprises which include those engaged in the production of cinematographic films and videos, electronic data processing, quality control, technical analysis and bench tests;
- Intensive dairy cattle farming, cattle rearing including processing of livestock products, beekeeping, poultry farming and/or the processing of such products, silkworm breeding for the production of dry cocoons, breeding and/or processing of shellfish, oysters and seaweed.

(4) Other Incentives for FDI

1) Tax Exemptions and Reductions

Foreign investors are able to benefit from tax exemptions, provided their projects fall into the following categories:

- Investment in export-oriented manufacturing industries.
- Development or management of industrial free zones, or
- Provision of services to EPZ companies.

Government is taking the necessary steps to enhance expenditure control, remove administrative bottlenecks to reduce investment delays, improve the tax system, and expand the tax base. Government decided not to renew the exemptions granted in the August 2003 tax and tariff relief law when it expired in September last year, and to avoid such exemptions in the future.

A company investing in Madagascar may benefit from the reduction of corporate tax of up to 50% of the total amount of investment made when the company is created or when its line of activities is extended. However, this tax reduction should not exceed 50% of the tax due for any financial year.

The balance of this credit may be carried forward for a period not exceeding five years. The investment only qualifies if it is made in assets and equipment used for commercial activities, which have a useful life of at least three years. The tax reduction is subject to the disclosure of the investment made on the balance sheet and on a statement annexed to the profit and loss account.

The *General Tax Code* no longer provides for the complete exemption of import duties and VAT on equipment, raw materials, construction materials, manufacturing, accessories, etc. The general trend in the recent past has been towards a decrease in import duties in respect of raw materials, other types of inputs for processing and also on equipment.

2) Tariffs and Customs

There are no discriminatory or preferential export or import policies, which will affect foreign investors. There are also no discriminatory tariff or non-tariff barriers, or other measures such as import controls.

In 2004, the efficiency of customs procedures were improved by intensifying ex post controls, holding bi-weekly consultations with the private sector, and rotated customs agents on a regular basis. This resulted in a significant decrease in the average customs clearance time, in some cases from 48 hours to 24 hours or less in the main customs offices.

The revision in customs tariffs envisaged in the 2005 Finance Law, which led to tariff reductions for more than 200 goods, including rice, form part of a broader plan to rationalise customs tariffs within the four existing tariff bands of five, ten, 20 and 25 %. Authorities are still evaluating the impact of the tariff revisions on the average weighted tariff. Customs staff is currently investigating the possibility of refining the reclassification of goods within the four tariff bands.

(5) Impediments to Attract FDI

According to the IMF, the major issues for the Madagascar government are; vitalization of the private sector through restoration of financial regulation and improved balance, and enhanced support for start-up and business activities; export and investment promotion; and structural reform to achieve rapid and sustainable economic growth. Under the rule of President Ravalomanana, there have been some results from administrative and system reforms, but there are also still occasional instances of unexpected functional disorder in administrative procedures.

The Heritage Foundation in the USA issued a document called the “Madagascar 2005 Index of Economic Freedom”, which pointed out that the administrative procedures to establish a new company take a lot of time, including the necessity of presenting a start-up plan with consideration of this delay. In fact, however, the time until the start of operations has been shortened as a result of simplification of the start-up and incorporation processes assisted by GUIDE, and businesses community have positive opinions about the series of reforms. The current administration is diligently tracking down government corruption that leads to invisible costs reduction, an effort that is wholeheartedly welcomed by the private sector. Nevertheless, there are still those who point out that there is redundancy and ambiguity in procedures required by the government agencies when starting a business, and that the workings pace of the bureaucracy are slow, so there is still room for improvement. Furthermore, the personnel at GUIDE is limited, and there is insufficient data to determine whether the same handling speed will be possible as the number of investment cases increases in the future.

Although the speed of the improvements is accelerating, businesses are still focused on the problems of the still-fragile economic infrastructure, investment-friendly measures besides tax measures, and the lack of public support for educating and training the necessary personnel. For the latter, the official language is French, but an adequate study of English is also important.

4.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

The government is aware that the growth of foreign investments, the development of the ecotourism potential, the increase in agricultural production and the improvement of social services all depend on the competitiveness of the transport services and the existence of a basic transport infrastructure. Unfortunately, the 2002 political crisis severely gave damaged on those infrastructures, especially on roads. Since then, one of the priorities of President Ravalomanana's economic reform programme has been putting on the rehabilitation of road infrastructures to open up isolated regions.

The road network is now no more than 15,000 km, whereas it used to cover 24,000 km in 1960. Over 80% of this network is in a state that ranges from passable to bad and it is largely impracticable in the rainy season. Since road construction and rehabilitation remains on of the priorities of government, the state has set itself the task of decentralising construction and repair work, and of maintaining a priority network, linking the different regions. The government plans to spend a total of US$1.16 billion by 2008, of which US$963 million will go to the road sector. The railway is the other mode that could give considerable impacts on improvement of logistics, if being rehabilitated and becoming operational. The railways are relatively stronger than the roads against the natural hazard such as cyclone which seasonally hit the country. Therefore in some case, companies prefer the development of railways. The rail network in Madagascar is 1,095km, however not all the network is operational at present due to the dilapidated state of fixed infrastructure and rolling stock. National entity, Regie nationale des chemins de fer malgaches is in charge of the railway operation but partly introducing the concession is under plan, which depends on the line. Apart from land transportation, Madagascar has 12 main airports, of which 5 are international airports. Recently, the international airport was extended and renovated, and new equipment was installed at Ivato airport. The numbers of seaports are 18, of which 12 are local and 6 international. The ports of Toliara and Mahajanga were both renovated during the past two years.

In the past two years, the transport sector has played a major role in boosting economic growth, mainly due to investment and maintenance work done on roads, the reinforcement and rehabilitation of the rail infrastructure, the upgrading of ports, inland waterways, and airports. However, the level of infrastructures in the country remains low and poor in light of the size of the territory, the scattered population and the rugged relief. The sparse infrastructure leaves many major markets isolated and cut off from each other, and thus represents a key constraint on the development of all the other sectors of the economy and access to socio-educational services in Madagascar.

Electricity production covers only 8.9% of national needs. According to the CIA Factbook 2005, Electricity production was 840.2 million kWh in 2002, while electricity consumption in the same period was 781.4 million kWh. Demand and supply gap is shrinking gradually. The privatisation of the electricity and water utility, Jior sy Rano Malagasy (Jirama), is also in progress. Service rendered by the electricity utility, Jirama, in terms of installations and repairs were traditionally not always as efficient and speedy as required by clients. However, progress in terms of service rendering might have taken place since board members have changed.

Modernisation of the telecommunications system in Madagascar is progressing, as all major cities have automatic exchanges and all international communications have been automated. According to the CIA World Factbook 2005, Madagascar had 59,600 main telephone lines in use in 2003 and 279,500 mobile cellular phones during the same period.

(2) Regional Programme

There are no collaborative projects except one in telecommunications known up to now. The country is a member of participants for an undersea fibre optic cable plan in East Africa, which gives international connection to Europe and America for countries such as Tanzania, Mozambique and

Madagascar. It is said that the cable would create a cheaper alternative to existing satellite-based transmission systems while adding extra capacity[49]. This year Madagascar has become a member of SADC. In the future any other cooperative project may arise in infrastructure.

(3) Trend in Privatisation and Some Observations on Current PPPs

The Ministry of Private Sector Development and Privatisation works for the issues, aiming at the increase of economic efficiency, private investment, and economic growth. The government compiled an initial list of 46 companies to be privatised out of a total of 140 state-owned companies. Of these 46 companies, 15 have already been privatised. Now it is planned for the telecommunications and utility companies.

Using concession is often taken by the government in order to make the infrastructure work and provide more efficient service than ever. Already practical accomplishments are observed in the sectors such as railways, port's terminals, water supply and power generation. In railway sector, Madarail which owned by South African company operate the northern line for 25 years. In the sector for ports, On 26 May 2005, Philippine port operator International Container Terminal Services Inc. (ICTSI) won the bidding for a 20-year concession to operate and develop the container terminal at the port of Toamasina. The government said bringing in a private operator for the port's container terminal is part of Madagascar's effort to become a bigger player in the shipping business. IFC[50] has said the new port contract would improve efficiency and capacity of the terminal and lower the cost of Madagascar's goods sent to market.

In addition, the World Bank Second Private Sector Development Project, is still ongoing, and has, according to the Bank, the objective to assist the government to improve access, reliability and affordability of key utilities, through completion of the divestiture program of key state-owned enterprises, and capacity building initiatives to strengthen the capacity of autonomous regulators and privatization agencies, and facilitate entry of new operators in the deregulated sectors, and increase the competitiveness of Malagasy companies.

4.3.3 Currency and Monetary Systems

(1) General Conditions

Madagascar suffers now high rate of inflation due to soaring foods and petroleum prices. Vanilla business is also adversely affected by price decrease in an unstable market. It is immediately desired to reconstruct sustainable fiscal and monetary policy in order to prevent its own currency from suddenly depreciating in the market and to control the rampant inflation.

The central bank raised the official bank base rate from 7% to 16% in 2004 as an anti-inflationary measure, but it was less successful as the inflation was led by import. Hike of international petroleum price, damages of crops by cyclones and weakness of its own currency are likely to continue to be factors of such high-rate inflation.

The inflation rate in 2004 is 15% on overage, but if weather and crops are normal, it may decrease to at around 10% level in 2005.

Suspension of import tax incentives for import in 2005 would work as a break against increase of import, which led to a lowering demand of foreign currency. But there is no hope that the long

[49] Refer to JETRO (2004) for the detail.
[50] IFC guided its process. The role of the IFC in the whole bidding process added both transparency and credibility to it, and supported the message of government’s commitment to develop the economy with the help of private partnerships.

sustaining depreciation of its own currency would come to an end. EIU forecasts the exchange rate will be Mgfr10,400/US$ in 2005 and Mgfr10,900 in 2006.

In November 1996, IMF granted Enhanced Structural Adjustment Facility (ESAF) to Madagascar. In March 1997, World Bank also granted Structural Adjustment Credits (SAC's) to Madagascar. In the framework of these reforms, the Government introduced the floating system of exchange rate in inter-bank exchange transactions, and relaxed import control. Ratio of external current deficit to GDP was higher than 6 % on overage of the recent 6 years, and it stood at 4% in 1999. Despite a 67 % cut of external debts in Paris Club in March 1997, Madagascar's external debts amounts now to US$ 3.3 billion, which is a heavy burden on the country.

(2) Banking sector

As in much of Africa, business growth and competitiveness are hampered by the shortcomings of the financial sector. More than one-third of assets are in the hands of the BCM, while most of the rest were held by the five commercial banks. Of the latter, BNI-Credit Lyonnais (BNI-CL) the Banque Malgache de L'Ocean Indien (part of Banque Nationale de Paris) and Union Commercial Bank and privately owned, is efficient and profitable. However, the state-owned Banky Fampandrosoana ny Varotra (BFV) and Bankin'ny Tantsaha Mpamokatra (BTM) saw their reserves eroded by lax and sometimes politically motivated lending. BFV was privatised in October 1998, when France's Sociètè Generale paid FMg 65 billion for a 70% controlling stake. Sociètè Generale's motive was to secure a foothold in a market where two of its main French competitors, BNP and Credit Lyonnais, already have a solid presence. The total assets of the biggest domestic bank, BNI-CL, amount to about US$200 million.

Other deposit-taking institutions service the many Malagasy who live in areas without bank branches or are too poor to meet commercial bank client criteria. The savings bank, the Caisse d'epargne de Madagascar, became a corporation in 1995. There are also four networks of co-operative savings and loan associations, the Mutuelles d'epargne et de credit (MEC) which grouped 148 associations in 1996, with a total of 15,000 members. Such institutions are viewed by international development agencies as crucial to the creation of business growth and financial security at the grass roots level. Madagascar also has two state owned insurance companies, N Y Havana and ARO, two small mutual insurers specialising in motor cover, Avotra and Mama. There is a social security fund, the Caisse nationale de prevoyance, which caters for some 330 00 employees in 18,000 economic enterprises, with contributions paid mainly by employers. Civil servants have a separate government social security scheme.

The financial sector is not sufficiently developed so as to provide the services required by small borrowers. Numerous initiatives of creditors and donors aim at the granting of micro-credit. Government supports the establishment of credit unions and other suitable credit facilities, and encourage creditors and donors to harmonise their efforts in this regard. The availability of local financing has been generally constrained by the BCM, in order to control inflation in the wake of large public sector fiscal deficits,

The country assures investment guarantees as a member of the MIGA to protect investors against non-commercial risks. The government guarantees the security of investments and capital, and also guarantees individual and corporate property rights. Government guarantees the free transfer of currency abroad.

(3) Foreign Exchange Controls

In 1998, government accepted the obligations of Article VIII of the IMF Articles of Agreement, which provides for the complete elimination of exchange controls. All restrictions on current payment and transfers were lifted. There are no restrictions on converting or transferring funds associated with a foreign investment, including remittances of investment capital, earnings, loan repayments, and lease payments into a freely usable currency at a legal market clearing rate. Delays are usually due to temporary shortages of foreign exchange. Foreign investors are also allowed to have bank accounts in foreign currencies.

Government will continue to allow the exchange rate to be market determined. The new inter-bank foreign exchange market (MID), which was introduced during July 2004, has functioned smoothly so far, and has contributed to the stabilisation of the exchange rate. According to the BCM's operation guidelines for interventions in the MID, the BCM will only intervene in the foreign exchange market to lessen the effect of sharp swings in the exchange rate, as well as to meet the BCM's objective of net foreign assets accumulation. Since mid-2004, the BCM has refrained from intervening in foreign exchange. The flexible exchange rate policy goes hand-in-hand with the prudent macro-economic policies and structural reforms, in order to maintain the country's external competitiveness.

4.3.4 Labor and Management

In 2001 the International Labor Organization (ILO) estimated the unemployment rate in Madagascar as 3.6%. However, the estimates of local government insiders agree with the view that it is significantly higher, with a 2-digit rate. The population is shifting to urban areas from the rural areas that have little industry except for the agriculture, fishing and forestry industries and some tourist industry. This not only raises the unemployment rate but also feeds a growing informal sector and contributes to deteriorating public order. As a result, there is an abundance of cheap labor in the cities, where the majority of EPZ businesses are situated, and there are concentrations of foreign capital and manufacturing. On the other hand, at various business sites there is arbitrary application of labor laws and low labor productivity due to inappropriate forms of employment through, and a mismatch between type of employment and wage levels, labor conditions, educations and technical standards.

Companies launching operations in Madagascar often praise the diligence of the laborers and the speed with which they learn techniques, but there are problems with language skills (particularly English), and the difficulty securing highly-skilled labor. With respect to personnel training costs, companies are entitled to a 10% tax reduction by law, but this benefit is not generally used, or is not widely known. In many cases the costs to a company entering the market include implementation of complete job training for employee, including language instruction. The lack of management and supervisory personnel to run companies also puts the brakes on the expansion and diversification of Madagascar's private sector. Factors include (1) Although basic education (primary and secondary) is widespread, there are low levels of higher-level education, (2) employers cannot develop or utilize domestic labor from a long-term perspective to develop technicians or management, and (3) low wage levels cause high quality labor to seek work abroad. As a result of this situation, the government is accepting foreign laborers, and has not enacted no policy-based restrictions, such as obligations to hire local citizens (setting minimum ratios). The same is true for the issue of residence visas for foreigners and the work permits. For foreign investors this is a two-edged sword.

Madagascar has been unable to comply with ILO standards, such as the 14 being the minimum age for permission to work. These factors lead to poverty and systemic weakness. A consensus was reached between private sector labor and the national labor organization, 'Madagascar Labor Movement', and negotiations between labor and the government were started in 2004. The current wage level is $38.5 USD per month, and is the lowest in the world. The upper limit for a legal length of a work day, including the standard work period and the maximum amount of overtime, is 14 hours, and a week of work is defined as 40 hours. However, more than half of the laborers surveyed by the ILO worked more than the legal limits. As part of this, is a practice called "free overtime". The overtime pay rate is a 30% increase over the hourly wage for the first 8 hours, and a 50% premium after that. There are restrictions on working overnight, and the maximum number of work days per week is 6. In the manufacturing industry employees who have been working for 20 years or more are granted a maximum of 24 paid vacation days.

Madagascar labor laws specify standards and regulations on worker safety and the working environment. Except for companies funded by capital from advanced countries and export companies targeting advanced countries like the USA, however, the labor regulations are not strictly observed. There are labor laws to protect workers from unfair firing, and labor unions have been established based on these. However, not only is there non-compliance with laws and regulations, the union organization rate is low, particularly in the rural areas. The labor unions themselves seemed to have had a privileged position for many years during the socialistic era, and workers may still have a sense of distrust.

HIV/AIDS is a social and economic problem common to the southern African region. The number of infected people in Madagascar in 2003 was comparatively low, with 130,000 adults and 8,600 children affected. As an island nation there is a geographical separation, and waves of workers do not swarm through the region. Even so the infection rate has been climbing. Since 2002 the government has been implementing an Anti-AIDS strategy that will continue through 2006. In addition a joint project to prevent the spread of HIV/AIDS was started in 2004 with Mauritius.

4.4. Official Development Assistance (ODA)

4.4.1 Overview of assistance by donors and international organizations

Madagascar maintains a strong relationship with France. In addition, the majority of the people are Malagasy with cultural and historical ties both to Africa and Asia. In addition, from the perspective of promoting FDI, it is seeking stronger relationships with other industrial countries such as Germany, the US, Canada and Japan.

Multilateral and bilateral donors including the World Bank and the IMF are active in the country and donor coordination is prominent. The government has pursued economic reforms and stabilization programs sponsored by the World Bank and the IMF. Donors are brought together in regular local donor meetings and through the Friends of Madagascar donor meetings. In 2002, during the donor conference in Paris attended by the EU, Japan and the US, Madagascar was promised US$ 2.3 billion by international donors to help it rebuild an economy shattered by a six-month tug of war over the presidency. Half of this amount is come directly from the European Commission and the World Bank. In addition, France promised US$150 million with the US contributing US$100 million.[51].

Multiple donor participation can be seen in the areas of the government's PRSP, support for community development and the transport sector, education financing, rural development, and post-cyclone reconstruction projects. Donors are also working to harmonize their budget support assistance. Below is an overview of assistance by major donors.

Table 4.4: Economic Cooperation towards Madagascar by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	Italy 134.2	France 79.3	France 46.5	France 41.7	France 46.3
2nd	France 68.9	Japan 49.1	United States 31.6	United States 37.2	United States 41.7
3rd	Japan 52.0	United States 29.1	Japan 26.3	Japan 25.5	Germany 8.6
4th	United States 30.3	Germany 16.9	Germany 14.2	Germany 10.0	Japan 7.6
5th	Germany 28.7	Switzerland 6.5	Norway /Switzerland 4.5	Spain 7.7	Switzerland 6.0
Japan	52.0	49.1	26.3	25.5	7.6
Total					

51 BBC World news source.

	333.7	192.5	138.7	137.9	125.9

Source: Compiled by MOFA Japan from OECD/DAC

4.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

In late 2002, Japan has gradually restarted aid that had been temporarily halted since 2001 due to instabilities caused by the political turmoil. By 2003, grant aid has resumed. In 2003, the Agreement of Technical Cooperation was signed between Japan and Madagascar. This was second of such agreement to be signed in Sub Saharan Africa, after South Africa.

In the policy consultations on technical assistance and grants aids in 1997, assistances for basic human needs areas, infrastructure for local development, agriculture, fishing, environment and human resources areas were affirmed. Through further ODA task force discussions in Madagascar, the priority areas were specified as: 1) healthcare including maternal and infant health, and infectious diseases; 2) access to safe water; 3) sustainable agricultural development, forestry and environmental protection; 4) greater access to basic education and human resources development; 5) transport infrastructure development to encourage economic growth; and 6) commercial fishing industry.

Below is the overview of Japan's assistance to Madagascar. In the infrastructure area, 67 million JPY was given to the Route 7 Bypass Construction Plan. In technical assistance, Japan is assisting in projects to train technicians and researchers to promote the shrimp fishing, which is a key driver in the local and national economy.

Table 4.5: Recent ODA to Madagascar

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-1.25	20.34	6.36	25.46
2002	-1.21	4.80	4.00	7.60
2003	-1.31	6.47	4.55	9.70
Cumulative Total	124.54	427.01	90.08	641.68

Source: Compiled by MOFA from OECD/DAC

(2) United States

USAID assistance support the promotion of good governance and market-driven growth as mechanisms to improve management of Madagascar’s unique natural resources in a sustainable manner, to reduce poverty, and to improve the health of the general population. The goal of the FY 2003 – 2008 Integrated Strategic Plan is "Sustainable and Inclusive Economic Development." It is composed of four strategic objectives: 1)"Governance in Targeted Areas Improved" (Democracy and Governance); 2) "Use of Selected Health Services and Products Increased, and Practices Improved" (Health, Population and Nutrition); 3) "Biologically Diverse Forest Ecosystems Conserved" (Environment and Rural Development); and 4) "Critical Private Markets Expanded" (Economic Growth).

The Economic Growth program emphasizes export market development. The program is building Madagascar’s promising product chains and trade capacity, and encouraging investment through strengthening linkages between producers, enterprises, and external markets, increasing access to finance and more productive technology; improving the enabling environment for trade and investment; and promoting public-private partnerships.

(3) United Kingdom

DFID does not operate in this country. Instead, the UK gives assistance only through the European

Commission.

(4) France

In 2004, ODA amounted to €53 million. There remain strong vested interests by France as the former colonial power and biggest trading partner. The AFD (French Agency for Development) has been involved with aid to Madagascar since its independence in 1960. After the political crises of 2002, AFD has been assisting in the country's reconstruction efforts and in restarting activities to which the Malagasy authorities had pledged themselves. The AFD thus contributed to the setting-up of a guarantee fund for small and medium businesses in collaboration with local banks, and also financed the renovation of the port of Morondava, as well as a road and public sanitation project. Below is a breakdown of the involvements of the AFD in the past five years by sector.

Table 4.6: Recent Aid by AFD to Madagascar （by sector）

（€ million）

	1999	2000	2001	2002	2003	2004
Rural Development			14.02	5.20		1.40
Microfinance/Banks	3.81		3.20	3.80		
Infrastructures	7.62	10.85		12.60	8.00	12.50
Environment (FFEM)	0.14	1.30	1.96	0.41		
Education		0.15			8.50	
FEPP		0.75			1.50	
Private Sector (PROPARCO)	18.25	4.41	13.18	0.00		
S/Total Projects	29.82	17.46	32.36	22.01	18.00	13.90
Adjustments	12.20				10.00	
C2D						22.84
Total (Engagements)	42.02	17.46	32.36	22.01	28.00	26.69

Source: L'Agence Francaise de Developpement

(5) World Bank

The World Bank is operating seventeen projects with total commitments of around US$947.1 million. Infrastructure represents the largest share of commitments, followed by social sectors and rural development. The World Bank Country Assistance Strategy (CAS) for 2004-06 is centrred on the Government's PRSP and focuses on helping the government implement its three strategic areas: 1) good governance; 2) broad based growth; and 3) improved human security. In particular, the emphasis over the three year CAS period is to support the government's priorities of transport and education, and governance/service delivery with an emphasis on fighting rural poverty.

IFC's committed portfolio in Madagascar is US$11 million. Madagascar is one of the countries in the initial pilot for the IDA-IFC SME initiative. It is also one of three pilot countries for the establishment of a new IFC delivery platform to provide an integrated package of services and financing to SMEs, SME Solutions Centers (SSC). In Madagascar, it was officially inaugurated by the President in 2004.

MIGA's outstanding portfolio in Madagascar consists of two contracts of guarantee in power sector with a gross exposure of US$0.8 million and a net exposure of US$0.4 million. Madagascar participates in MIGA's Africa Enterprise Benchmarking Program (EBP), under which it will be benchmarked against eight African countries and potential competitors from other regions as a location for investment in six promising sectors: apparel, textiles, call centres, tourism, processed food and horticulture. The program is closely coordinated with the Investment Climate Assessment work under way in the country. In addition, the Sasol oil and gas project is the first cross-border initiative to develop regional gas markets in the sub-Saharan region, involving the development of Mozambique’s natural gas fields, the construction of an 865 km cross border gas pipeline from Mozambique to South Africa and the construction of a central processing facility. The project will replace coal and heavy oils with clean-burning natural gas. MIGA has provided US$186 million worth of guarantees for equity investments and debt financing for the project.

Madagascar is among the WBI priority countries and is delivering a capacity enhancement program. The WBI has assisted the government to design, develop and implement three government learning retreats since June 2003.

5. MALAWI

5.1. Trends of Macro Economy, Industry, Trade and Industry

5.1.1 Macro Economy

According to the USAID report entitled the *Economic Performance Assessment*, Malawi's lackluster economic performance will have to improve dramatically if the lives of the people are to be bettered. The report was based on an examination of key economic and social indicators, including growth, poverty levels (65% of Malawians live below the poverty line), and access to healthcare and education. The report also said broad-based growth was the key to poverty reduction, while, at the same time, measures to invest in human capital, reduce poverty and lessen inequality help to underpin rapid and sustainable growth. In total, Malawi urgently needs to follow through on recent efforts to strengthen macro-economic management, and to take steps to further improve the enabling environment for private sector development. This will entail deeper reforms, control of corruption, infrastructure investment, and better health and education programmers, within the limits sets by very scarce resources, the report pointed out. Over the past five years, growth has averaged only 1.2% per year, never exceeding 4%, which means that growth remains too low to improve the standards of living or adequate income opportunities for a population, which is growing by 2.1% per year. In order to progress to prosperity, sustained growth of no less than 5% is needed, which is the main economic challenge facing the government and the donor community.

In the past, macro-economic management problems have prevented Malawi from qualifying for the PRGF's concessional loans from the IMF and resulted in donors withholding funds from Malawi on the condition that fiscal discipline had to be restored prior to the release of such funds. According to the recent IMF statement, the government has made good progress in "demonstrating its commitment to sound macroeconomic policies" and talks regarding the PRGF arrangement were underway. During April 2005, the IMF mission visited Malawi to review its performance under the Staff Monitored Program (SMP) through end-March this year. The mission also continued discussions on policies that could be supported under a PRGF arrangement. The IMF said all key quantitative performance criteria were met, with the exception of an overrun on the government payroll that stemmed from the civil service pay reform undertaken in October 2004. The costs of the wage reforms were initially underestimated, because of the complexity of the old system. According to the IMF, the overall performance under the SMP reflects a high degree of commitment by the government to adhere to its budget. The IMF also said it has reached tentative understandings with the government on a macro-economic framework and policies that would be covered under the PRGF arrangement. Structural economic policy discussions were anchored by the objectives of the Malawi Poverty Reduction Strategy, the Malawi Economic Growth Strategy, and measures to strengthen public expenditure management. The IMF mission noted that good progress was made in the current fiscal year regarding the upgrading of government's expenditure controls. The government has also requested financial assistance from the international community to address the maize shortfall. The IMF will work with the government, international donors and the World Bank in order to identify these resources. According to a Memorandum of Economic and Fiscal Policies (MEFP) sent by the government to the IMF, the country expects to save US$14 million from three fiscal measures. A third of this amount will be saved in the domestically financed development budget by focusing on ongoing projects before starting with new ones. Donors finance about 80% of the development budget. In early July 2005, the debate on the budget bill for 2005/2006 was delayed by the suspension of parliament following the death of the Speaker during a debate on whether to impeach President Mutharika. Passing the new budget is crucial to restoring IMF aid to the country.

The business community said the country is failing to progress because its budgets continue to be dependent on donors. They said to avoid continued dependence on donors; government should formulate a strategic plan, which will increase the economic base for the people of the country. It was suggested that government should help in the commercialization of small-scale farmers so that they would be able to yield more from small pieces of land. The Minister of Finance, Goodall Gondwe said of the US$1 billion proposed new budget for 2005/2006, US$565 million will come from domestic revenue sources, and US$391 million from grants. There will be a budget deficit of US$68 million.

Due to the decline in foreign currency reserves, the local currency has lost its stability against the dollar and other major trading currencies. With inflation already running high at 14%, due to declining food supplies, economic commentators predict that the depreciation of the local currency will result in importing higher inflation into Malawi. In addition, during late March 2005, the Reserve Bank of Malawi (RBM) said the country was experiencing an acute shortage of forex due to a decline in official foreign currency reserves. The RBM appealed for the market to stay calm, as they expected the situation to have improved by the end of March, when tobacco sales were starting. Tobacco accounts for more than 60% of Malawi's total foreign revenues.

In early 2005, according to the EIU, President Mutharika raised the possibility of introducing a currency band within which the currency would be allowed to move freely. However, no further information was provided, but President Mutharika has in the past indicated his preference for a strong and stable currency, which he considers to be a sign of economic vitality. The EIU is of the opinion that any exchange rate policy other than a free float would distort the economy, and that keeping the currency strong would be damaging to the competitiveness of non-traditional exports. In addition to this, limited foreign exchange reserves would make it difficult for the RBM to manage such an exchange rate regime over a sustained period of time. It is also expected that donors are unlikely to approve of the idea. In view of the current shortages of foreign exchange the currency is likely to remain under pressure or weaken in the short to medium term.

Table 5.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	4.0	5.4	7.4	9.4	9.9	10.1	10.3	10.5	10.7	11.0
Population ages 0-14 (% of total)	46.0	47.2	47.2	46.4	46.3	46.1	44.2	44.4	44.7	44.9
Population ages 15-64 (% of total)	51.6	50.6	50.2	50.9	51.2	51.4	52.1	52.0	51.9	51.8
Population ages 65 and above (% of total)	2.4	2.2	2.5	2.7	2.5	2.5	3.7	3.6	3.5	3.4
GDP (constant million 2000 US$)	447.3	802.2	1,068.1	1,461.4	1,622.3	1,687.8	1,706.7	1,622.8	1,651.5	1,724.2
GDP growth (annual %)	4.8	6.2	2.2	3.7	3.3	4.0	1.1	-4.9	1.8	4.4
GDP per capita (constant 2000 US$)	110.3	148.6	144.6	155.0	164.1	167.2	165.5	154.2	153.7	157.3
Official exchange rate (LCU per US$, period average)	0.8	0.8	1.8	20.1	31.1	44.1	59.5	72.2	76.7	97.4
Inflation, consumer prices (annual %)	-	-	16.3	32.8	29.7	44.8	29.6	22.7	14.7	9.6
Money and quasi money (M2) as % of GDP	16.6	19.8	20.0	16.5	14.7	14.2	15.4	16.8	17.7	19.1
Real interest rate (%)	-	0.8	3.8	5.2	9.8	8.0	21.6	22.6	30.8	33.9
Foreign direct investment, net inflows (% of GDP)	3.0	1.6	0.6	0.5	0.7	3.2	1.5	1.1	0.3	1.3
Foreign direct investment, net inflows (% of gross capital formation)	11.5	6.4	3.3	4.3	5.2	21.8	15.9	109.9	2.5	16.5
Agriculture, value added (% of GDP)	47.8	43.0	44.3	36.1	33.5	35.4	36.9	36.4	36.7	38.4
Industry, value added (% of GDP)	13.7	19.3	23.3	21.6	18.4	17.9	17.4	16.4	14.9	14.9
Manufacturing, value added (% of GDP)	-	13.0	15.6	15.6	13.6	13.2	12.6	11.4	9.9	9.5
Services, etc., value added (% of GDP)	38.5	37.8	32.4	42.3	48.1	46.7	45.7	47.3	48.4	46.7
General government final consumption expenditure (% of GDP)	17.0	15.3	17.1	15.7	13.3	12.4	16.7	18.1	18.4	20.1
Household final consumption expenditure, etc. (% of GDP)	82.6	70.2	69.9	82.6	79.2	87.8	86.1	92.1	87.4	84.9
Final consumption expenditure (% of GDP)	99.7	85.6	87.1	98.2	92.5	100.2	102.8	110.2	105.8	105.0
Gross capital formation (% of GDP)	14.4	27.1	19.2	16.3	13.5	14.8	9.6	1.0	12.5	8.1
Exports of goods and services (% of GDP)	22.0	26.3	23.6	25.2	32.4	27.5	26.2	28.2	25.4	27.5
Imports of goods and services (% of GDP)	36.0	39.0	29.8	39.7	38.4	42.5	38.5	39.4	43.7	40.6
Gross domestic savings (% of GDP)	0.3	14.4	12.9	1.8	7.5	-0.2	-2.8	-10.2	-5.8	-5.0
Gross capital formation (% of GDP)	14.4	27.1	19.2	16.3	13.5	14.8	9.6	1.0	12.5	8.1
Food exports (% of merchandise exports)	91.1	92.9	93.4	89.2	91.5	88.9	89.4	86.9	85.1	86.1
Food imports (% of merchandise imports)	16.1	9.8	8.5	13.0	20.1	12.0	10.4	11.6	23.5	16.9
Agricultural raw materials exports (% of merchandise exports)	6.3	2.9	1.5	2.8	1.4	2.1	3.0	2.5	2.7	2.0
Agricultural raw materials imports (% of merchandise imports)	1.1	0.9	1.1	1.0	1.0	1.3	1.6	1.7	1.1	1.4
Ores and metals exports (% of merchandise exports)	0.2	0.1	0.0	0.1	0.0	0.1	0.2	0.2	0.3	0.1
Ores and metals imports (% of merchandise imports)	1.3	1.5	1.5	1.0	1.1	0.9	0.7	0.5	0.9	0.9
Fuel exports (% of merchandise exports)	0.0	0.0	0.0	0.2	0.1	0.3	0.2	0.1	0.0	0.0
Fuel imports (% of merchandise imports)	5.4	11.6	14.4	11.1	9.6	11.6	15.3	16.7	11.1	11.9

Manufactures exports (% of merchandise exports)	2.1	3.7	4.9	7.7	6.9	8.7	7.1	10.2	11.8	11.8
Manufactures imports (% of merchandise imports)	73.7	75.6	74.1	73.6	68.2	74.0	71.9	69.3	63.4	68.6
Aid per capita (current US$)	6.7	13.1	32.0	50.4	44.0	44.2	43.3	38.4	35.1	45.4
Total debt service (% of exports of goods and services)	-	18.8	35.3	19.0	14.4	13.1	12.5	8.0	6.3	7.7
Total reserves in months of imports	-	2.2	1.7	2.5	4.6	3.8	4.4	3.7	2.4	2.3

The World Bank (2005), W*orld Development Indicators: 2005*

5.1.2 Industry

The inland nation of Malawi has 11 million people residing in a relatively small territory, so its population density is high. It has neither any sea port nor geographically accessible ones in neighbouring countries. Under these disadvantageous factors,, the nation's diversification of domestic industry and value-added creation have fallen behind in the region as well, and have left the country in the situation of excessive dependence on aid, agriculture. Regarding the exogenous circumstances, the environment for sustainable development was affected by the deterioration of foreign relations with its neighbouring countries as a price for its one-party dictatorship and pro-South African stance over a long period since its independence. The result is that the people's livelihood and the domestic economy are tied to the amount of agriculture production, and quite strongly impacted by weather such as droughts. It is also interpreted to say that the nation has been out of regional business network for long.

The main industries are agriculture and fishing, and although they are tending toward a slight decrease still account for 37% of GDP (in 2002). Declines in mining and manufacturing production show no signs of halting, dropping to 15% (of that manufacturing accounted for 10%), which was half of what it was in 1990. That gap is being filled by the service industry (49%).

The agriculture sector cultivates self-sufficiency crops such as maize, cassava (tapioca), pulses and sweet potatoes. Endowed with relatively rich soil, but due to its dependence on rainfall because of an undeveloped irrigation network, the country is apparently not able to achieve food self-sufficiency in some years. Tobacco, sugarcane and tea are its main cash crops in addition to coffee, macadamia nuts and rubber which are produced by commercial farms or small-scale farms. Tobacco is purchased by European companies and directed for export. Sugarcane is shipped to domestic sugar manufactories. Due to the high population density, there are many small farms, and because sufficient fertilizer and agrochemicals are not able to be utilized, the added value per person engaged in agriculture has risen to only about one-third of the average in Sub-Saharan Africa. In regard to fisheries, Lake Malawi stretches out along the eastern edge of the country, and catches by mostly small-scale fisherman amount to 70 thousand tons annually. Most of this is consumed in domestic markets.

As for mining, exploitation of lime, limestone, stone and precious stones takes place in the mining sector, but the ratio of GDP that it occupies is about 1% (in 2002). 40 thousand tons of lime is produced annually for domestic consumption, and rich reserves are estimated to be 150 million tons (SADC data) with the expectation that investment in development will be increased. Limestone is mainly processed for use as agricultural lime or as a material for cement. As for manufacturing, while food processing has risen to 44% of GDP (in 2000), chemicals at 16%, textiles at 8%, and machinery at 5%, all have narrow cluster. The principal products are foods such as sugar, drinks, garment and leather products, timber and metal processing for construction materials. Sugar and tobacco are shipped for export, and most of the other products are headed for the domestic market. There are a limited number of domestic companies, mainly settled by South African and European capital. In the future, it will be necessary to design a system to support companies in their efforts to development new markets such as promoting exports, mainly textile products, to the US through utilization the preferential tax mechanism of the AGOA and exploiting markets in surrounding nations.

In the service industry, as with other nations, attention is to be paid to tourism. In this country whose tourism resources include two international airports, the immense Lake Malawi and five national nature reserves, the number of tourists increased from 130 thousand in 1990 to 290 thousand in 2002 as well as a rise in tourism revenue from US$20 million to US$130 million. Executing development projects over the short- to medium-term for lodging facilities and equipment as well as ameliorating the transportation infrastructure carry the potential to foster industries which will create employment opportunities and new foreign cash source. The necessary minimum number of companies is present in the financial and distribution industries, and as with the tourism industry, there is a strong presence of South African capitals.

5.1.3 Trade and Investment

(1) Trade

Agricultural products are the major exports of Malawi. Tobacco shares about half of total exports followed by sugar, clothing and textiles. Other commodities have a wide range of diversity, include beans and pulses, dhals, chillies, tea, coffee, macadamia nuts, rice, confectionery, ceramics, crafts, farm implements, fishing flies, furniture, gemstones, enamelware, rubber, live tropical fish, cut flowers, buses and trailers.

South Africa is the biggest trading partner of Malawi, in both export and import. Malawi has a bilateral agreement with South Africa whereby Malawi exports attract a reduced tariff in South Africa. As the major source of imports, Malawi imports petroleum products, fertilizers, iron or steel, electrical goods, machinery, pharmaceuticals and dairy products from South Africa. Malawi has preferential access to the European Union for most of its agricultural commodities and virtually all of its manufactured products, and benefited from US' AGOA in agricultural commodities and textile/apparel products export.

Production levels and world market prices for tobacco, tea, sugar and cotton dominate Malawi's foreign trade balance. In particular, tobacco sales are affected by cross-border trade, low prices, post harvest losses, high farm inputs and high interest rates.

Table 5.2: Trade tendency and main partners

（US$ million）

		1998	1999	2000	2001	2002
Export		563	498	446	481	477
Import		667	769	657	672	822
Main trading partners						
Export	South Africa	82.48	74.71	40.59	37.57	40.78
	United States	58.82	69.09	53.82	76.55	69.45
	Germany	56.74	72.14	29.29	55.92	54.60
Import	South Africa	238.53	258.15	260.25	240.82	261.35
	Zambia	50.92	66.08	62.75	69.03	74.92
	Zimbabwe	68.53	80.26	52.36	9.61	10.43

Source：World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

Although FDI inflow to Malawi remains the lowest level among the SADC countries, In 2003, the Malawi Investment Promotion Agency (MIPA) facilitated about US$25,16 million worth of investment pledges, which created employment opportunities for about 12 000 people.

According to a publication on the Garment Industry in Malawi in 2004, two large Taiwanese owned companies dominate the sector employing over half (approximately 5500 workers) of all those employed in the formal garment manufacturing sector in Malawi. This investment came in after the Bilateral Investment Agreement (BIT) between Taiwan and Malawi was signed in 1995. Lesotho and Swaziland attracted far more investment under a similar agreement tending to suggest these countries as preferred investor destinations. The bulk of AGOA related profits that are currently being accumulated in Malawi similarly to Lesotho and Swaziland are going to foreign and in particular

Taiwanese companies and not local manufacturers. Given the ease of repatriation of profits for foreign investors very little of the investment and industry benefits the local people. There is one large domestically owned company employing some 1,500 workers, the rest of the garment industry is made up of several small to medium sized foreign owned and local companies employing between 30 and 500 workers.

Table 5.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
12.1	58.5	26.0	19.3	5.9	23.0

Source: UNCTAD, FDI On-line.

Table 5.4: Largest affiliates of foreign TNCs, 2004

(US$ million and number)

Company	Home Economy	Industry	Sales	Employment
Mandala	Britain	Chemicals	…	2,000
Bata Shoe company	Canada	Leather and leather products	…	380
Commercial Bank	South Africa	Finance	Assets: 161	763
Celtel Malawi	Netherlands	Telecommunications	…	92
Gestetner	Britain	Other business services	…	70
Valmore Paints	Britain	Chemicals	…	60

Source: UNCTAD, FDI in brief: Malawi

5.2. Policy Issues Promoting FDI

5.2.1 Industrial Policies and Development Plans

Since state revenues are only able to cover two-thirds of its expenditure, Malawi's public finances are heavily dependent on aid. Consequently, the nation's economic policies are placed under the strong influence of the IMF. Currently, the IMF is recommending that the government strengthen its fiscal discipline by curtailing domestic borrowing and constraining personnel expenses in the public sector, improving the collection of taxes and other measures in an attempt to curb inflation and new liabilities as well as to extend private sector funding. While attempting to tighten public expenditure, the government has streamlined and cut customs tariffs to an average of 14% so as to reduce production costs in the private sector in addition to deregulating import restrictions. Regarding the industry development policies by sector, the government faces the task of improving its administrative performance premised on the formulation of medium-term strategy, which in turn include a focus on short-term policies such as development of a tourism infrastructure and the distribution of seeds and fertilizer for free to small farmers during droughts.

5.2.2 FDI Promoting Policies

Malawi has taken a number of initiatives to create an investor friendly environment and attract more investment. Apart from the repeal of the Forfeiture Act of 1992, there are effective laws, which are derived from English Common Law, to protect foreign investment. An institution to promote, encourage and facilitate FDI in Malawi, the Malawian Investment Promotion Agency (MIPA), was established under the Investment Promotion Act of 1991. MIPA operates as a one-stop investment centre, which assures investors of speedy and efficient services regarding investment approval.

According to the government, investment opportunities exist in the following sectors:

- Mtwara Development Corridor: Infrastructure.

- Manufacturing: Cotton spinning, weaving and finishing mill, textile accessories, garment manufacturing, soya bean oil-extraction, fruit juice process, rubber products, wood processing and sisal processing.
- Mining: Phosphate fertiliser manufacturing.
- Agriculture: Cut flower production, fish farming, cotton growing through contract farming.
- Tourism: Hotels, lodges, conference centres.

(1) Restrictions or Special Provisions

There is no government screening of foreign investment in Malawi. Apart from the privatization programme, the government's overall economic and industrial policy does not have discriminatory effects on foreign investors. Restrictions are based on environmental, health, and national security concerns.

All regulations affecting trade (foreign exchange, taxes, etc.) apply equally to domestic and foreign investors. As of March 2002, Malawi had privatized 48 of approximately 110 state-owned enterprises targeted for privatization. All investors, irrespective of ethnic group or source of capital (foreign or local) may participate in the privatization programme. However, the Malawi stock exchange regulations limit participation of an individual foreign portfolio investor to a maximum of 10% of any class or category of security under the program and limit maximum total foreign investment in any portfolio to 49%.

1) Empowerment

There is a noteworthy movement which might have a possibility to affect on the abovementioned non-discriminatory treatment between domestic and foreign investor. On 11 May 2005, the government said it will set up a National Economic Empowerment Commission (NEEC) to execute the *National Economic Empowerment Programme (NEEP)* through an Act of Parliament. The NEEC will be autonomous, but will still fall under the Ministry of Trade and Private Sector Development. The Secretary for Economic Planning and Development, Patrick Chilambe, said the Act will also facilitate the establishment of what he called transformation sectors. The law shall also establish the *National Economic Empowerment Fund (NEEF)*, which will mobilize and create a wholesale revolving fund. Chilambe said the Commission will carry out information, education and communication activities; facilitate the development of sector charters and propose changes to various types of legislation for effective delivery of economic empowerment.

The NEEC will also monitor and evaluate the effectiveness of the empowerment programme using set targets like empowerment, through increased direct ownership and control of enterprises by Malawians. Other yardsticks include economic empowerment through preferential procurement and enterprise development, human resource development and employment levels of women, youth and the disabled. The empowerment strategy will concentrate on institutional and legal frameworks, access to financial services, capital, science and technology, and means of production. Other focal points of the strategy include access to land and rural development, capacity building, improving infrastructure and promotion of entrepreneurship culture. Government will also develop strategies to economically empower rural communities, women, youth and people with disabilities.

5.3. Incentives and Impediments for/to FDI

5.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

1) Malawi Investment Promotion Agency (MIPA)

The government is committed to closely cooperate with the private sector and has enhanced the relationship through the establishment of the *Investment Promotion Act of 1991* and the creation of the Malawi Investment Promotion Agency (MIPA), an investment body whose board is made up of representatives from the private sector, parastatal sector and government. In March 2001, the government granted MIPA the status of a One Stop Investment Centre with the authority to make speedy approvals on investment applications based on clear guidelines.

The reasoning behind the establishment of MIPA was to facilitate the investment process for investors, ensuring that all the required information was available in one place, and to assist investors in acquiring all the necessary permits, licences and approvals. According to the mission statement of MIPA, it shall be the catalyst in the transformation of Malawi into a broad-based export-led economy.

The responsibility of MIPA includes:

- Developing a favourable investment image of Malawi
- Recommending to government changes in the statutory and administrative framework relevant to the investment climate
- Facilitating all aspects of the investment process in Malawi
- Furnishing information related to investment in Malawi
- Identifying partners in or outside Malawi for joint venture business opportunities
- Working with local and international financial institutions for the benefit of investors
- Encouraging existing investors to start or expand or start new investment
- Consulting with private sector organizations so that better informed recommendations concerning the investment climate can be made

2) Ministry of Trade and Private Sector Development

The Ministry of Trade and Private Sector Development has drawn up a number of interventions in support of private sector developments. The interventions include re-organizing and strengthening support institutions such as MIPA, strengthening the policy and regulatory environment by developing new policies and legislation on counterfeit and consumer protection and the safeguarding of local industries from unfair competition, strengthening export capacity by developing sectoral development strategies, intensifying bilateral, regional and multilateral trade and investment promotion, strengthening Malawi's trade and investments representation in key markets such as in South Africa, the US and Asia among others.

(2) Export Processing Zones

Legislation for the establishment of Export Processing Zones (EPZs) came into force in December 1995. All companies engaged exclusively in manufacturing for export can apply for EPZ status and enjoy special incentives. A Manufacturing Under Bond (MUB) scheme offers slightly less attractive incentives to companies that export some, but not all, of their manufactures.

The EPZ programme offers duty-free importation of machinery and raw materials and 0% corporate tax to potential and current investors. In 2003, the EPZ scheme attracted a combined capital investment of Malawi Kwacha 1.3 billion and created employment opportunities for 5 590 people.

Investors are now also going into non-traditional sectors including mining and agro-processing.

The Minister of Commerce and Industry is empowered to declare any area or factory as an EPZ and is responsible for the issuance of export enterprise certificates.

At the end of 2004, 14 firms held licenses to operate under EPZ status, and all were operational. The full range of labour regulations applied to the EPZs; however, union organisers said they had little access to workers in the EPZs[52].

(3) Incentives for FDI

The government is anxious to attract foreign investment in both the public as well as the private sector, seeking to encourage the private sector to take the leading role in developing the economy. Tax incentives are enshrined in the main tax legislations that include the Customs and Excise Act, the *Income Tax Act* and the *Export Processing Zones (EPZ) Act.* The incentives are available to all qualifying local and foreign investors.

According to the government, Malawi offers an attractive investment climate, and encourages local and foreign investment in any sector of the economy, with no restrictions on ownership. The investment climate features minimum requirements for company incorporation, modern telecommunications facilities, easy international flight connections, preferential access to regional and international markets, easy access to regional markets, friendly and welcoming business environment, long standing commitment to private enterprise, low cost, trainable and productive labour force, and adequate power supply and clean tap water for domestic and industrial use.

According to MIPA documentation, incentives for investors are the following:

<u>1) General Incentives</u>:

- Additional 15% allowance for investments in designated areas of the country;
- Allowance up to 20% for used buildings and machinery;
- 50% allowance for qualifying training costs;
- Allowance for manufacturing companies to deduct all operating expenses incurred up to 24 months prior to the start of operations;
- Zero-duty on raw materials used in manufacturing;
- Indefinite loss carry forward enabling companies to take advantage of tax allowances;
- Duty free importation of heavy commercial vehicles with payloads of at least 10 tonnes; and
- Agreement for the reduction of withholding taxes on remittance and payments.

<u>2) Fiscal Incentives</u>:

- Investors have free access to foreign exchange in Malawi, both for paying for imports and transferring financial payments abroad.

<u>3) Export Incentives: Incentives for Industries Manufacturing in Bond</u>

- Export tax allowance equal to 12% of export revenue for non-traditional exports;
- Transport tax allowance of 25% for international transport costs, excluding traditional exports, etc;

[52] According to the US Department of State Country Report on Human Rights 2004, released by the Bureau of Democracy, Human Rights, and Labour, February 2005.

4) Incentives for Horticultural Produce:

- Exporters engaged exclusively in horticultural products for export receive 100% duty-free importation of equipment and raw materials.

5) Tax Exemptions and Reductions

Malawi has a corporate tax rate of 30% for Malawi-headquartered companies, and a rate of 40% for those whose head offices are not in Malawi. According to Lex Africa's Legal Guide to Business and Member Firms February 2005, tax is levied on income from actual and deemed Malawi sources at the following rates:

- 30% for companies and trading trusts (35% for branch companies) and 21% for life assurance business.
- Graduated rates from 0% up to 30%, based on annual income, for individuals and partnerships.
- 0% for approved companies operating in the EPZs
- 0% for 10 years for companies operating in priority industries.

Manufacturers are permitted an investment allowance of 40% of the cost of new and unused industrial buildings, plant or machinery brought into use in the year of assessment and used in the process of manufacture, excluding motor vehicles. Manufacturers and persons engaged in farming may deduct 5% in respect of the construction of houses for their staff.

6) Tariffs and Customs

The government is harmonising the duty, surtax and excise over a period of time in accordance with its regional obligations with COMESA and SADC Trade protocols, aimed at reducing taxes payable on goods originating from COMESA and SADC countries by 2008.

In order to pay for imports, prior permission is required from authorised dealers who process these applications. Any importation to the value of US$2 000 is required to be inspected by the Societe Generale de Surveillance SA (SGS).

7) Subsidies

Government will subsidize the price of fertiliser for farmers under the Expanded Target Input Programme to stimulate food production.

(4) Impediments to Attract FDI

In the past, issues such as bureaucracy and slow decision-making in government were deterrents to new investment. Although government said it wants to open up the economy to allow participation by foreign investors, at the operational level, the investment process can still be bogged down by too much red tape. According to the Malawi 2005 Index of Economic Freedom as published by the Heritage Foundation, procedural delays, red tape, and corrupt practices continue to impede the business and investment approval process. These include decision making, which is often neither transparent nor based purely on merit, and required land-access approvals.

On a comparative basis, Malawi sits in the uncomfortable situation of being amongst the least attractive investment distinctions in SADC. Without a significant natural resource base, it is relatively remote and has little to offer in terms of manufacturing and human potential. Its biggest drawback is that all of its neighbours have far more to offer an investor.

5.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

The absence of adequate infrastructure in Malawi remains a major impediment for growth in agriculture and industry. Transport costs are among the highest in the region, by some estimates almost 2.5 to 3 times higher than those prevailing in South Africa and Zimbabwe. Over 40% of Malawi's total import bill is attributable to transport costs. Malawi has a 16,450km road network. Paved roads extend from Blantyre to the borders of Mozambique, from Lilongwe to the Zambian border, and from Karonga to the Tanzanian border. British Airways, the only airline offering direct flights from Malawi to Europe, ceased flying to Malawi in March 2004. Rail freight links are being bolstered by the development of the Nacala Corridor, but in 2003, domestic freight moved by rail declined by 37.9% while domestic passenger traffic declined by 18.6%. As for ports, the Nacala freight line through Mozambique has been improved greatly and the route to the ports on the Indian Ocean reopened.

In the power sector, the inability of the Electricity Supply Corporation of Malawi (ESCOM) to provide reliable power services results in substantial losses to industry. Wood fuel continues to be the dominant source of energy in the economy. It accounts for about 93% of the total energy consumption. Demand for wood fuel exceeds the available sustainable supply and the deficit is increasing every year. Malawi’s oil industry was liberalised in 1999.

Although MIPA informs investors that telecommunications is excellent, Malawi is characterised by a telephone penetration rate that is just 60% of the average for sub-Saharan Africa, with waiting periods for a telephone reaching as high as ten years.

(2) Regional Programme

Because of country's inland location, Corridor projects are crucial for Malawi to be competitive in the market. Developing the entire 802 km Nacala Corridor (from port to Nayuchi in Machinga) has already proceed. Plans are underway for the consortium to invest in wagons, upgrade the sea port at Nacala. This development is expected to improve transport facilities along the Corridor and draw Malawi's traffic away from the land routes, thereby reducing Malawi's share of transport costs in its total import bill by as much as half.

The other Corridor project, namely the Mtwara Development Corridor launched together with Tanzania, Zambia and Mozambique in mid-December 2004. The project aimed at integrating their transport networks and promoting growth in the region. President Mutharika said the 850 km US$2,6 billion project linking the four countries would encourage cross-border trade and investment. The four countries plan to build new roads, railway lines and airports, refurbish shipping, and develop export-oriented industries. The project is expected to create at least 250,000 new jobs, and to help boost regional tourism. The corridor runs from the southeastern Tanzanian port of Mtwara through the country's southern highlands to Lake Malawi and into northern Mozambique and eastern Zambia.

(3) Trend in Privatisation and Some Observations on Current PPPs

Malawi has already made considerable achievements in privatisation of public entities. The government's attitudes towards pro-privatisation are formed after taking account of the legacy of past inefficient interventions. As of June 2004, 61 public enterprises out of approximately 110[53] are privatised including basic physical instructors such as roads, power, and communications. According to the Privatisation Commission of Malawi[54], the government will seek no role in the competitive market beyond that of neutral arbiter ultimately.

[53] Approximately 140 public enterprises and some 30 assets exists in all. Of which about 110 enterprises or assets have a commercial orientation and have or should have financial autonomy.
[54] the sole authority in Malawi to implement the privatisation of the direct or indirect government ownership of any public enterprise.

A *"Public Enterprises (Privatisation) Act"* was passed by Parliament in March 1996 and it was assented to by the State President on 17th April 1996. The Act, which sets out the objectives and guidelines for the privatisation programme, also establishes the institutional set-up for the execution of the privatisation programme. Each transaction will be fully transparent to the public at large[55]. All investors, irrespective of ethnic group or source of capital (foreign or local) are free to participate in the privatisation programme. The privatisation process will be fair and efficient. An independent opinion of value will be obtained for each enterprise to be privatised. Full disclosure of the details of the enterprise will be available to the investing public and fair and equitable bidding procedures and criteria for ranking bids will be established and published. It is the intention of Government not to set any conditions concerning the future operations of a privatised enterprise. A fund entitled the Privatisation Revenue Account will be established and placed under the control of the Ministry of Finance. This fund may with the approval of the Minister of Finance, be used for a limited number of purposes, namely, funding the direct costs of the Commission and the privatisation programme, funding the restructuring of public enterprises to be privatised including payment of retrenchment benefits, the remainder of the fund will be applied to projects included within the Government development budget.

According to the Privatisation Commission of Malawi, Malawi Telecommunications Limited (MTL) is included for this year plans for infrastructure development. Also, preparatory work is ongoing for the privatisation of airports. Although government has already commenced with the initial phases for the privatisation of MTL this year, the situation is changing. The EIU introduced that a deal for the privatisation was agreed in November 2003 with Telecom Holdings Limited (THL), an international consortium[56]. However a local newspaper [57]reported the sudden cancellation of MTL sale in august this year. It is seen that the cancellation will have a bearing on all other future transactions than MTL in the country.

5.3.3 Currency and Monetary Systems

(1) General Conditions

Reserve Bank of Malawi, the Central Bank, makes every effort to manage money supply and to control inflation. But it is not always successful. The growth of money supply decreased from 33.7% in January 2001 to 17.5% in April 2002 and to 9% in December 2003 vis-à-vis the same month of the last year due to a rigid monetary policy, but increased again in 2004. The official discount rate cut and decease of deposit requirement rate for commercial banks as expected cannot be thus conducted. Central Bank's policy to urge commercial banks to increase loans to private sectors is maintained, but is not realized until the inflationary pressure weakens.

Inflationary factors are increase of money supply at the time of election, soaring foods and petroleum prices, depreciation of kwacha, etc. Inflation rate which stood at 11.4% in 2004 on average will decrease slightly in 2006, if some conditions including establishment of fiscal discipline are satisfied.

The Government intervened in the exchange market in 2004 in order to prevent its own currency from depreciating, but such strategy has its limit due to restricted volume of foreign reserves. In addition, the suspension of tobacco auction, a major resource for acquiring foreign currency, contributes to depreciation of kwacha. According to EIU report, the exchange rate is expected to be

[55] In this regard the Privatisation Commission will publicise details of all completed activities of the privatisation programme.

[56] The consortium consisted of a local conglomerate comprising Press Corporation Limited (PCL), CDC Capital Parners and Detecom Internation, which is a unit of Deutsche Telecom. The first two will provide the finance and the latter the technical expertise. However, the structure of the consortium was revised, and the Development Bank of South Africa and Standard Bank will now provide the finance that was originally offered by CDC.

[57] The Chronicle Newspaper, August 25, 2005"Privatisation Process in a Dilemma Following Govt's Cancellation of MTL Sale"

MK115.5/US$ in 2005 and MK125/US$ in 2006.

(2) Banking Sector

Malawi has a relatively sound financial sector well supervised and controlled by the Central Bank. There are 6 commercial banks (First Merchant Bank Limited, Finance Bank of Malawi, Indefinance, National Bank of Malawi (NBM), Stanbic Bank (SB), Loita Investment Bank). Other financial institutions are: Investment and Development Bank of Malawi (INDEBANK), Investment and Development Fund (INDEFUND), Malawi Development Corporation (MDC), Finance Corporation of Malawi (FINCOM), Leasing and Finance Company of Malawi (LFC), Malawi Savings Bank (MSB), New Building Society(NBS), Finance Company(MRFC),Continental Discount House, First Discount House, etc.

As of May 2004, outstanding balance of loans to public sectors by banks was MK 28,389 million (about US$258 million) and that to private businesses was MK 9,543 million (about 86 million US$).

NMB and SB have predominated over the private banking sector of Malawi for 30 years. The two had a more than 80% share in the market as of December, 2003.

World Bank and African Development Banks are expected to play a role of provider of project finances. Local financing organizations including INDEBANK may raise funds from World Bank or Regional Development Banks for domestic investors who desire foreign exchange transactions.

Malawi is a member of the International Centre for the Settlement of Investment Disputes(ICSID) and joined the Multilateral Investment Guarantee Agency (MIGA) in 1986. The country is also a signatory to bilateral investment protection and promotion agreements with several countries, including Malaysia, the Republic of China and Mauritius.

(3) Stock Market

As for stock market, Malawi Securities Exchange (MSE) is operating. Listed companies are 8. According to ERA study, nominal value of equities of companies listed in MSE was US$5,771 million and their market capitalization was MK 418,352 Million (US$3,800 million). Stock Brokers Malawi Limited (SML) is a major equities intermediary. SML is operating the secondary market of Government bonds. SML had operated MSE in accordance with a 3 years agreement with RBM until April 1, 2000. Thereafter it established two intermediating companies: Continental Discount House and First Discount House in order to play the role of a broker and a regulator separately. MSE continues to be under control of Stock Exchange Commission.

(4) Foreign Exchange Controls

The country’s current account has been fully liberalised and investors in Malawi have unrestricted access to foreign exchange, both for paying for imports and transferring financial payments abroad. Regular exporters are allowed to operate foreign currency accounts with local banks. However, with the recent crisis regarding a shortage of foreign currency, the immediate availability of foreign exchange will remain dependent upon supply, which tends to vary depending on the season (specifically in terms of agricultural production and related income). In recent times, government has been rationing residents with regard to foreign exchange purchases.

5.3.4 Labor and Management

In early 1999, the government established the technical, entrepreneurial and vocational education and training (TEVET) program to address technical skills shortages in industry. Though skilful labour is still scarce, the local labour force is plentiful in general in the country.

Expatriate personnel may be employed to cover manpower shortages and key posts in specific areas. However, the government believes that a genuine and sustainable partnership with foreign investors can only be built on the basis of increased participation of national citizens in positions of key responsibility and decision-making. A foreign resident requires a permit to reside in Malawi, and may not take up employment or engage in any business, profession or other occupation unless his permit authorises such activity. The availability of permission depends on the size or type of business activities of each investment project.[58]

There are two separate urban and rural minimum wage rates[59] decreed by the Ministry of Labour and Vocational Training, which is low compared with those in other African countries. Because minimum wage rates did not provide a decent standard of living for a worker and family, employees often supplemented their incomes through self-farming activities. The maximum legal working time is 48 hours per week, with a mandatory weekly 24-hour rest period. The laws require payment for overtime work and prohibit compulsory overtime. In practice, employers frequently violated statutory time restrictions. It is also responding to employees' needs so as to maximize their income.

Although the low prohibits the employment of children less than 14 years of age, there was significant child labour on collective tobacco and tea farms, independent farms, and in domestic service. This is due to extreme poverty and longstanding cultural traditions. In 2003, the government trained approximately 120 labour officers in child labour monitoring, and has held continuous training since that time.

Although trade unions' activities are not a significant fear for firms, the government's policy is to encourage negotiations and collective bargaining between employers and employees. Union leaders estimated that 12% of the formal sector workforce belonged to unions. Employers, labour unions, and the government lacked sufficient knowledge of their legitimate roles in labour-management relations and disputes, which limited their effectiveness in the implementation and enforcement of the law. The law prohibits anti-union discrimination by employers and requires that employers reinstate workers dismissed because of union activities. The law requires that at least 20% of employees (excluding senior managerial staff) belong to a union before such a union can engage in collective bargaining at the enterprise level and at least 15% union membership for collective bargaining at the sector level.

UNAIDS statistics for 2003 show 14.2% or 810,000 of adults (ages 15–49) with HIV/AIDS, of which 56% are women and 10% are children.

5.4. Official Development Assistance (ODA)

5.4.1 Overview of assistance by donors and international organizations

ODA to Malawi totals about US$400 million per year, excluding debt relief. The European Commission, United Nations and the World Bank are the major multilateral agencies active in Malawi. The UK, the US, Germany, Canada, Netherlands and Japan are the major bilateral donors. The PRSP has contributed to improving donor coordination. There is the Aid Coordination Group which aims to strengthen government capacity. There are sectoral donor working groups in the areas of economic management, poverty reduction, water and agriculture. Donor harmonization work is expected to be

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[58] In order to be eligible for a Business Residence Permit (BRP), the investor must invest at least US$50, 000. Application forms are available from Malawi Investment Promotion Agency (MIPA). Where the level of investment is up to US$100,000, an investor can obtain employment permits for two key positions. If an investment exceeds US$100,000, the requirements to be met regarding working permits are given more serious consideration.

[59] In the cities of Blantyre, Lilongwe, Mzuzu and the Municipality of Zomba, MK 50.00 (US$ 0.55) per day; In the Townships and all other areas, MK 37.00 (US$0.40) per day.

focused on the health sector specifically in the area of HIV/AIDS, where a sector-wide approach is taken.

There is also cooperation between donors at the individual projects level. For example, cooperation was observed on the country program assistances between Norway and Sweden and also between Switzerland and the Netherlands, in education between the UK and Netherlands, in health between Norway and Sweden and also between Canada and Japan, in water development between Canada and Japan, and in energy between Germany and the Netherlands.

The UK is by far the largest bilateral donor to Malawi and works in many sectors including budget support. Germany focuses on health, education and democratic decentralization, Norway addresses HIV/AIDS, health, education, agriculture and natural resources management. Japan concentrates on agriculture and infrastructure. Canada focuses on health, HIV/AIDS, education and accountability. The EU concentrates in transport infrastructure, health and conservation of natural resources, including agriculture.

Denmark, Sweden, UK, Norway and the EU provide budgetary support. They have created the Common Approach to Budgetary Support group (CABS) to coordinate their macro-financial support.

Table 5.5: Economic Cooperation towards Malawi by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	United Kingdom 56.7	United Kingdom 77.3	United Kingdom 96.9	United Kingdom 66.5	United States 61.2
2nd	Japan 47.4	Japan 34.0	United States 59.3	United States 30.6	United Kingdom 50.2
3rd	Germany 25.5	Germany 28.7	Japan 38.5	Denmark 21.6	Germany 24.0
4th	Denmark 22.6	Denmark 28.4	Germany 25.5	Germany 19.8	Japan 18.8
5th	United States 19.7	United States 27.8	Denmark 24.9	Japan 18.3	Holland 16.9
Japan	47.4	34.0	38.5	18.3	18.8
Total	203.6	227.7	269.2	195.8	224.9

Source: Compiled by MOFA Japan from OECD/DAC

The PRSP does not integrate trade into its four pillars and thus was given low priority to trade. It allocates less than one percent of its resources to trade. The EU aims to mainstream trade into its transport, agriculture and macroeconomic support – as well as to directly fund work on Malawi's interests in a regional economic partnership agreement with the EU. It plans some WTO-related capacity building in the government and the university. World Bank, USAID, UNDP, the WTO and GTZ are now also involved with trade-related areas. It is expected that an Integrated Framework will be used to coordinate these various projects.

5.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

Japan has recognized Malawi's efforts on democracy and pro-poor economic reforms. Through discussions between the two countries, the following five areas are specified as the priority issues: 1) basic needs assistance; 2) economic infrastructure; 3) SME development; 4) human resources development for sustainable growth; and 5) environment protection. Regarding economic infrastructure development, Japan has been considering assistance in the trading centers to promote electricity distributions in rural areas and development of basic economic infrastructure including transport to vitalize economic activities. Japan has given grants in food and healthcare.

Table 5.6: Recent ODA to Malawi

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-8.38	14.26	12.42	18.29
2002	-8.55	16.01	11.35	18.81
2003	-3.54	20.94	14.01	31.41
Cumulative Total	183.39	351.26	191.32	725.93

Source: Compiled by MOFA from OECD/DAC

(2) United Kingdom

DFID's country program priorities for 2002-2005 are measures to ensure sustainable growth and improve livelihoods, better service delivery to the poor and pro-poor governance. DFID has supported a number of trade-related projects, addressing both trade policy and trade development. A strategy to guide the selection and design of these trade projects is under consideration, which will integrate trade with an enabling environment for private sector development. Since 2000, DFID has spent just over one million GBP a year on five trade projects. Examples of these are the Malawi Trade and Poverty Programme (MTPP) (£1,261,000 budgeted for 2000-05), Training for Enterprise and Exports in Malawi (TEEM) (£2,921,000 budgeted for 2000-05), and the Improved Cotton Seeds project financed by the Business Linkages Challenge Fund (BLCF) (£295,000 budgeted for 2003-06). In addition, DFID has funded a series of value-chain studies and workshops in five export-oriented sectors, through the Private Sector Partnerships (PSP) (£200,000 during 2001-2003). It also funded the costs of the secretariat for the National Action Group – a multi-stakeholder group addressing private sector development issues (£191,000 during 2002-04). Finally, Malawi should benefit from the DFID-funded Southern African Regional Trade Facilitation project (£12million for 2003-07)[60].

(3) World Bank

World Bank's lending to Malawi totals US$2.4 billion. Work Bank has thirteen active projects in Malawi with a total commitment of US$369 million. Of these funds, 20% was allocated to rural development, 33% for public and private development and finance, 8% for transport and almost 39% for the social sectors. An example of the operations is the Global Development Learning Network, a US$4 million project that intends to strengthen the capacity of public, private, and civil society decision-makers and implementers to design, plan and manage social economic development policies and programs[61].

Malawi Country Assistance Strategy for 2004-06 focuses on: 1) strengthening economic management and accountability; 2) establishing a platform for long-term sustainable growth; and 3) improving service delivery and strengthening safety nets. World Bank also provides technical assistance on formulating sector investment strategies. The IMF has commitments of US$2.02 million in the capital markets, agribusiness, healthcare and tourism sectors.

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[60] Weston, A. and M. Tsoka (2004), "Evaluation of DFID support to trade-related capacity building: Malawi Case Study".

[61] World Bank

6. ANGOLA

6.1. Trends of Macro Economy, Industry, Trade and Industry

6.1.1 Macro Economy

Angola's economy is entering a crucial state, trying to prove itself as viable, modern and internationally credible, beyond the simple and obvious solution of multiplication of petroleum production. Part of the national effort is hampered by the host of problems identified by observers through the years, including a still divided society, corruption at higher circles and multiple levels, permanence of political and security instability, infrastructure destruction, mediocre to bad performance of the public corporate sector, lack of qualification and training for sufficient numbers of professionals and technicians, ad hoc policies, lack of coordination and short-sighted policies, slow pace towards elections and legitimating political power, slow pace towards agreements with the international organisations, excess external debt, etc.

Angola has come to depend overwhelmingly on oil for its export earnings, with the United States of America being the main market for Angola’s oil. Until recently, Angola has had few trade ties with other Southern African countries. However, now that there has been a change in the political climate, opportunities for trade with other countries in the region have opened up. Angola’s main export commodities are crude oil, diamonds, refined petroleum products, gas, coffee, sisal, fish and fish products, timber and cotton. The country’s export partners are the United States of America, China, France, Belgium and Japan. The primary imports are machinery and electrical equipment, vehicles and spare parts, medicines, food, textiles and military goods. Pharmaceuticals must be registered in advance with the Ministry of Health. A sanitary certificate is required for imports of seeds, plants, animals and animal products. The main import partners of Angola are Portugal, South Africa, the United States of America, France, Brazil, Netherlands and the United Kingdom. Total exports in 2003 are estimated at US$9.67 billion fob and imports at US$4.08 billion fob.

On March 4, 2005, the Executive Board of the IMF concluded the Article IV Consultation with Angola. Its report, just released, provides the most comprehensive and recent overview of the Angolan economy. Since the end of violent conflict in April 2002, about 4 million displaced Angolans have returned to their communities, supported by a government-led initiative to provide emergency food aid and humanitarian assistance, involving UN agencies and other donors. Nevertheless, poverty remains widespread. Income is highly concentrated, and health and social indicators are poor, although prevalence rates for HIV/AIDS are lower than in most of southern Africa. The physical infrastructure has been largely destroyed. In addition, the legacy of civil conflict includes sizable short-term external debt, a large public sector payroll, and state institutions that hold dominant positions in critical areas of the economy with limited accountability.

GDP grew by 11% in 2004, following a slowdown in growth in 2003, largely reflecting the profile of oil production, which now accounts for half of GDP. The economy outside the extractive sector is currently estimated to be growing by about 9%. Despite extensive landmines and devastated infrastructure, which continue to restrict the availability of seed and fertilizer and impede marketing, agricultural production (largely by households) has recently begun to recover. The other principal identified sources of growth are construction and services. Inflation has declined substantially, to a 12-month rate of 31% in December 2004, following a major change in macroeconomic policy implementation in September 2003, known as the "hard kwanza" policy, which has largely stabilized the nominal exchange rate. This has involved liberalization of the foreign exchange market, and active absorption of domestic liquidity by central bank sales of foreign currency, to support a tightening in monetary policy based on improvements in fiscal control and domestic debt sales. The growth rate of reserve money fell from 160% in the 12 months to September 2003 to 19 percent one year later. Initial estimates indicate a substantial decline in the fiscal deficit between 2003 and 2004, reflecting the rise in oil prices, lower real spending on goods and services, and policies to reduce fuel subsidies, which raised gasoline prices to about US$1.50 per gallon by November 2004.

After a widening of the external current account deficit in 2003, caused in part by higher imports and services related to investments in the oil sector, Angola moved into significant surplus in 2004 as oil prices rose. Nevertheless, heavy gross external borrowing equivalent to 12% a year was undertaken by the public sector in 2003-04. A total of US$3.4 billion was raised from commercial banks in oil-backed loans and over US$0.5 billion was drawn from bilateral oil-backed credit lines. As a result, despite the substantial sales of foreign currency by the central bank, gross international reserves are estimated to have increased from US$0.4 billion at end-2002 to about US$2.2 billion at end-2004 (two months of imports), including an estimated US$660 million accumulated in foreign currency accounts managed by Sonangol on behalf of the government. Angola's external debt was estimated at US$9.5 billion at end-June 2004 (equivalent to about 49% of GDP) including late interest and arrears.

Important improvements have been made in the last two years in the fiscal accounts and the transparency of oil transactions. However, the independent oil diagnostic study published by the government in May 2004 indicated significant weakness in the governance of the oil sector, mainly reflecting continuing conflicts of interest as Sonangol, which acts as government concessionaire and regulator, is also a major operator in oil extraction and a provider of services to the industry. Sonangol's spending on behalf of the government also remains outside effective central government control and monitoring. The national diamond company Endiama also continues to act under conflicts of interest and, despite some reforms in the sector, transparency remains very limited. Progress on structural reform and the implementation of policies to deal systematically with poverty reduction has been limited. The state continues to exercise a heavy influence in many sectors. Noncompetitive practices, privileged access, and costly bureaucratic procedures hamper the growth of the non-oil private sector and contribute to high margins in domestic prices. The privatization process appears to have stalled. The draft PRSP distributed in December 2003 has not yet been finalized.

Table 6.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	5.2	6.3	8.4	11.0	11.7	12.0	12.4	12.7	13.1	13.5
Population ages 0-14 (% of total)	42.4	43.8	45.9	47.4	47.5	47.5	47.5	47.5	47.6	47.6
Population ages 15-64 (% of total)	54.8	53.3	51.2	49.7	49.6	49.6	49.6	49.6	49.5	49.4
Population ages 65 and above (% of total)	2.8	2.9	3.0	2.9	2.9	2.9	2.9	2.9	2.9	2.9
GDP (constant million 2000 US$)	-	6,537.3	7,193.8	7,447.6	8,318.0	8,596.3	8,858.1	9,138.5	10,537.0	11,011.0
GDP growth (annual %)	-	-	2.4	1.3	6.8	3.3	3.0	3.2	15.3	4.5
GDP per capita (constant 2000 US$)	-	927.5	856.2	676.2	708.6	713.6	715.2	716.9	803.0	814.3
Official exchange rate (LCU per US$, period average)	0.0	0.0	0.0	1.4	0.4	2.8	10.0	22.1	43.5	74.6
Inflation, consumer prices (annual %)	-	-	-	1,042.7	107.3	248.2	325.0	152.6	108.9	98.2
Money and quasi money (M2) as % of GDP	-	-	-	15.4	20.2	13.4	11.3	13.9	15.4	14.6
Real interest rate (%)	-	-	-	-55.5	7.2	-72.2	-60.0	-13.9	-2.9	2.0
Foreign direct investment, net inflows (% of GDP)	-	-	1.7	10.5	17.3	40.6	9.9	22.7	14.9	10.7
Foreign direct investment, net inflows (% of gross capital formation)	-	-	9.9	62.8	48.6	204.8	28.0	65.5	46.1	33.3
Agriculture, value added (% of GDP)	-	-	15.6	10.1	13.0	6.4	5.8	8.0	7.8	8.8
Industry, value added (% of GDP)	-	-	39.6	60.1	55.7	73.5	72.8	66.8	68.1	64.6
Manufacturing, value added (% of GDP)	-	-	7.9	4.6	6.3	3.3	3.0	3.8	3.7	4.1
Services, etc., value added (% of GDP)	-	-	44.7	29.8	31.3	20.2	21.4	25.3	24.1	26.6
General government final consumption expenditure (% of GDP)	-	-	32.0	42.2	-	-	-	-	-	-
Household final consumption expenditure, etc. (% of GDP)	-	-	43.1	44.3	-	-	-	-	-	-
Final consumption expenditure (% of GDP)	-	-	75.1	86.5	80.7	86.9	37.0	65.0	60.8	63.3
Gross capital formation (% of GDP)	-	-	14.3	21.7	35.5	19.8	35.4	34.6	32.2	32.2
Exports of goods and services (% of GDP)	-	-	35.4	69.5	56.9	87.0	92.4	71.1	76.5	71.3
Imports of goods and services (% of GDP)	-	-	24.8	66.3	73.1	93.7	64.7	70.7	69.6	66.8
Gross domestic savings (% of GDP)	-	-	24.9	24.9	19.3	13.1	63.0	35.0	39.2	36.7
Gross capital formation (% of GDP)	-	-	14.3	21.7	35.5	19.8	35.4	34.6	32.2	32.2
Food exports (% of merchandise exports)	53.3	28.9	2.7	32.9	-	-	65.5	-	-	-
Food imports (% of merchandise imports)	16.7	13.2	32.5	-	-	-	-	-	-	-
Agricultural raw materials exports (% of merchandise exports)	10.4	4.7	0.1	13.7	-	-	13.7	-	-	-
Agricultural raw materials imports (% of merchandise imports)	1.2	1.3	0.8	-	-	-	-	-	-	-
Ores and metals exports (% of merchandise exports)	9.4	4.1	3.2	4.4	-	-	3.9	-	-	-
Ores and metals imports (% of merchandise imports)	1.0	1.6	1.4	-	-	-	-	-	-	-
Fuel exports (% of merchandise exports)	7.9	49.3	87.8	48.9	-	-	3.0	-	-	-

Fuel imports (% of merchandise imports)	3.7	4.4	0.2	-	-	-	-	-	-	-
Manufactures exports (% of merchandise exports)	19.0	12.7	6.0	7.0	-	-	13.9	-	-	-
Manufactures imports (% of merchandise imports)	77.4	79.5	65.1	-	-	-	-	-	-	-
Aid per capita (current US$)	1.1	3.2	14.5	33.1	28.6	32.2	24.8	22.6	32.1	36.9
Total debt service (% of exports of goods and services)	-	-	8.3	16.9	41.4	26.8	20.7	22.7	16.3	14.9
Total reserves in months of imports	-	-	-	0.9	0.4	0.8	1.9	1.1	0.5	0.8

The World Bank (2005), *World Development Indicators: 2005*

6.1.2 Industry

Angola is similar to Mozambique in that its civil war against the backdrop of the Cold War between the East and West continued for a long time after its independence. Attempts at building peace and rehabilitating the economy in the 1990s both failed leaving the domestic industrial base in a state of devastation. In 2002, a peace agreement was concluded between the government and anti-government forces, and the economy and industry are in the process of being reconstructed sustained by developing petroleum sector and international aid. With vast cultivatable land and a long ocean coastline as well as large reserves of mineral resources, the nation is believed to have bigger potential for economic development comparing to the other regional countries. It is expectable to see a vast influx of foreign capital, emerging of new industries, and expansion of its domestic market if landmines are removed, commodity and foreign currency exchanges are stabilized, the existing infrastructure is rehabilitated, and economic ties are further strengthened with the surrounding countries.

Comparing the ratios that the major economic sectors accounted for in the 2002 GDP with those of 1990, agriculture and fishing stayed almost unchanged at 10%, mining and manufacturing rose to more than half from 48% to 53% (manufacturing alone was 8%), and the service industry declined to 37%. With all industrial sectors ceasing to function properly due to the long drawn out civil war, oil production, mainly offshore, solely supported the national economy, and government outlays dependent on increases in oil revenues made possible to maintain the minimum level of public's livelihood.

Agriculture was principally the cultivation of food crops for self consumption such as cassava and maize. The nation is a far from self-sufficiency and depends on food aid and imports. Taking a look at cash crops, the production of coffee, the country's principal export product after independence, has dropped considerably, and only the smallest amounts together with such products as bananas, tobacco and sugarcane, are produced and commercialized. Of the land that is cultivatable, no more than a mere 3% is being planted. Angola's coastal waters are blessed with a variety and abundance of marine products including horse mackerel, mackerel, tuna, sea bream, shellfish and cod. Many foreign capital fishing companies also have launched operations, but due to a lack of refrigerated distribution storage systems, the amount caught has not exceeded 250 thousand tons. The existence also of such tropical timber resources with high value added prices such as rosewood, ebony, white sandalwood and mahogany have been left for the most part untouched due to the civil war and infrastructure inadequacies.

The oil sector forms the crux of the secondary sector. In 2003, daily production of crude oil was 980 thousand barrels with 73% of that being exported. The nation's oil reserves are the fourth largest on the African continent at 8.8 billion barrels. European and United States oil majors are involved in development and production through joint ventures with the national oil company, and further production increases can also be expected. The oil producing region includes the Cabinda enclave within territory of the Democratic Republic of the Congo, and is mainly offshore. One refinery has been set up in the capital of Luanda and satisfies domestic demand, and construction of a second refinery with China is planned for the outskirts of the city of Lobit, located in southern part of the country. In regard to gas, the commercialization of associated gas will likely be the nation's first step. In the non-oil sector, diamond production accounted for more than 10% of GDP, and deposits of iron, copper, gold and precious stones have been confirmed. In the manufacturing industry, foreign investment is making some inroads, but is limited to the production of domestic consumer products such as food processing. In recent years, new buds have appeared, such as production of capital equipment and materials for such as the petroleum related industry and two-wheeled vehicle assemblies.

As for the service industry, in the financial sector where originally there had been nothing but government institutions, European and US foreign investment has made forays into this area raising expectations for improvement in the quality and amount of financial services. Commerce is still essentially under the control of the government and military, and the private sector is survived mainly in informal sectors. The public service sector is entirely limited to urban areas. In the tourism sector, the hotel industry is growing with the accompanying revitalization of business activity with outside countries. The growth might be accelerated by the FDI in the field of hotel construction in urban areas as well as the development of resort facilities in the coastal area.

6.1.3 Trade and Investment

(1) Trade

Angola has been overwhelmingly depended on oil for its export earnings, with the United States of America being the main market for Angola's oil. Angola is the third-largest source of imports to the US of all AGOA-eligible Sub-Saharan African countries, after Nigeria and South Africa. However, these imports are concentrated in the energy-related sectors. During 2002 energy-related goods shipped to the US from Angola accounted for 99% of Angola's total exports to that country.

Other main export commodities are diamonds, refined petroleum products, gas, coffee, sisal, fish and fish products, timber and cotton. The country's export partners are the US, China, France, Belgium and Japan. The primary imports are machinery and electrical equipment, vehicles and spare parts, medicines, food, textiles and military goods. The main import partners are Portugal, South Africa, the United States of America, France, Brazil, Netherlands and the UK.

Until recently, Angola has had few trade ties with other Southern African countries. However, due to a change in the political climate, opportunities for trade with other SADC countries in the region have opened up.

Table 6.2: Trade tendency and main partners

（US$ million）

		1998	1999	2000	2001	2002
Export		3,666	5,296	8,182	6,737	8,607
Import		4,714	5,705	5,735	6,697	7,827
Main trading partners						
Export	United States	2,227.91	2,336.64	3,285.09	2,979.36	2,977.55
	China	139.73	323.32	1675.18	656.21	988.23
	Belgium	316.55	482.15	566.73	507.41	451.76
Import	Portuguese	451.00	323.02	340.18	492.96	594.59
	United States	389.73	278.41	240.90	303.71	409.75
	South Africa	215.08	210.90	340.18	335.45	364.06

Source：World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

According to the UNCTAD, Angola was the second largest recipient of FDI in Sub-Saharan Africa in 2003 and the largest overall between 1999 and 2003. The World Bank estimates inward flows of $1.55 billion or about 9% of GDP in 2004, up from $1.42 billion in 2003, and projects $1.5 billion for 2005. The bulk of this investment was in the petroleum sector. According to major oil companies operating in Angola, the level of investment in the oil sector is expected to grow for the next ten to fifteen years as new oil reserves are developed for eventual production. Angola expects cumulative investment in the oil sector at $26 billion between 2003 and 2007, and US companies will account for about half of this new investment.

Table 6.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
1,113.9	2,471.4	878.5	2,145.5	1,643.4	1,414.7

Source: UNCTAD, FDI On-line.

Looking at the FDI by country, a high share for Portugal, the former colonial power, is recognized as expected. The high Russian figure relates directly to the strong presence of Russia in Angola's diamond mining sector. The BVI and Cayman Islands are off-shore jurisdictions, so the real origin of their share could be anywhere, even Angolans themselves.

The Chinese are currently buying their way into various sectors of the Angolan economy – at the cost of major loans; the US$2 billion ceiling for the current credit line for Angolan project finance may be raised on a simple request from the Angolan authorities. The Chinese are already acquiring stakes in the Angolan offshore oil industry, and are present in construction while showing a keen interest in mining; they are notably currently looking at the Mavoio copper reserves, and they have become major exporters of Chinese industrial consumer goods to the Angolan market.

The Chinese presence is all the more visible since Chinese construction enterprises and other companies have brought in thousands of Chinese workers – in a country that suffers from widespread unemployment.

The Indians have also established themselves in the Angolan market, backed by financial aid, although of a markedly smaller volume than that proposed by the Chinese. However, the Indian presence is not likely to create problems for others.

Both China and India have been attracted by Angola's oil resources, given their immense appetite for oil to fuel their fast-developing economies. But they are also looking for growth markets for their industrial products. It is especially in the construction and infrastructure sector that the greatest growth of the Chinese presence is expected, as the Chinese use their own loan to leverage development projects for Chinese firms. Already Chinese firms are set to build major additions to the university in Luanda, and this month it was announced that Chinese funds will be used to finance the construction of 18 new three-star hotels in each province, largely to improve the movement of businessmen in the country. This plan to have more affordable and accessible hotels across the country has been promoted by the Tourism Ministry for some years now, but it is only the conclusion of the Chinese loan that has seen the plan come to practical announcements.

During December, official figures revealed that China's trade with Angola had increased 93.1% year on year (figures for October 2004). Trade in January-October 2004 was US$3,492 billion. Angola became China's largest external supplier of crude oil at the end of 2004.

Table 6.4: Investment Approved per Country of Origin (US $ millions) [62]

Country	1990-99	2000	2001	2002	2003	2004	Total
South Africa	13,16	1,30	1,30	-	2,61	21,39	39,77
Germany					0,71	2,8	3,5
Algeria						0,25	0,25
Australia		1,50					1,50
Bahamas	0,25		0,25				0,50

[62] As this figure, together with the investment by sector, is provided by the Angola National Agency for Private Investment (ANIP), who does not handle the investment in petroleum, diamonds and the banking/financial system, these sectors are not included.

BVI	51,27			3,90	20,88	15,80	91,87
Belgium	2,06	0,3		0,25		0,20	2,81
Benin	0,50						0,50
Belize		0,25					0,25
Bermuda	4,31		6,73			33,94	44,99
Botswana	0,25				2,93	7,33	10,51
Brazil	49,15		0,38	0,25	0,416	8,17	58,37
Cape Verde	1,00				0,43		1,43
Canada	2,12	0,25				8,70	11,07
Cayman Islands	120,50				0,25	0,667	121,41
Comoros						2,85	2,85
Channel Islands	3,00			0,25	0,25		3,50
PR China	4,00	5,00	2,29	0,30	9,99		21,59
Cyprus						3,50	3,50
South Korea	7,95					0,86	8,81
Cote d’Ivoire		0,25	0,50		0,31	0,43	1,49
Cuba						0,19	0,19
Denmark	39,10					0,10	39,20
UAE			0,40	3,41	0,30	0,50	4,61
Spain	39,60	14,66		0,72		25,45	80,46
Bahrain	0,50						0,50
Ethiopia					5,00	0,21	5,21
Finland	2,074						2,074
France	101,78	0,25	0,50	4,46	5,08	2,13	114,21
Gabon	5,48	0,25				0,40	6,10
Gambia	1,13						1,13
Ghana	1,45						1,45
Gibraltar					0,50	0,28	0,78
Guinea- Conakry						0,25	0,25
Netherlands	3,00			0,45	0,50	0,40	4,35
Mauritius	38,64		0,25	0,25	4,70	1,40	45,24
India	0,25	0,25		0,25	0,25	3,42	4,42
UK	19,26	2,37	2,86		2,42	11,60	38,54
Ireland	30,89					0,500	31,39
Israel	0,45					0,23	0,68
Italy	41,32			0,25	0,50	0,31	42,39
Japan	0,84						0,84
Jordan	5,00					0,94	5,94
Yugoslavia	1,50						1,50
Lebanon	3,08	0,25	0,38		1,74	6,61	12,02
Liberia	0,28						0,28
Luxembourg	0,45					1,60	2,05
Malaysia	7,00						7,00
Mauritania	0,53					0,30	0,83
Mozambique						1,75	1,75
Namibia	1,99			0,28	0,49	0,71	3,49
Nigeria	43,90		0,25				44,15
Norway	0,25						0,25
Panama	11,63	0,25		0,25	5,82	6,49	24,45
Paraguay			0,35			1,12	1,47
Portugal	538,88	24,75	1,57	2,77	16,50	57,37	641,86
Czech Rep.	2,25					0,10	2,35
DRC	2,00					0,20	2,20
Russia	0,25				45,17	5,07	50,49
Sao Tome	0,50						0,50
Senegal	1,01						1,01
Sierra Leone		0,25					0,25

Singapore				0,25			0,25
Sweden	1,16						1,16
Switzerland	1,41				0,25	0,10	1,76
Thailand					0,10		0,10
USA	71,41	5,36		5,56	12,50	2,22	97,06
Lichtenstein	1,29	0,25					1,54

Source: National Agency for Private Investment (ANIP)

Table 6.5: Investment by Sector - 2002-2003

Sector	No Projects 2002	Value (US$million) 2002	No Projects 2003	Value (US$million) 2003
Agriculture	2	14.8	5	23.8
Industry	6	10.2	39	151.9
Petroleum	4	4.9	4	12.8
Mining	0	0	5	6.6
Commerce	9	7.3	20	13.2
Fisheries	4	24.5	5	25.3
Tourism & Hotels	1	0.5	1	2.0
Construction	11	58.0	35	77.4
Services	6	202.1	34	226.6

Source: National Agency for Private Investment (ANIP)

6.2. Policy Issues Promoting FDI

6.2.1 Industrial Policies and Development Plans

With the conclusion of the civil war which had extended over a quarter of a century, the government has enjoyed the advent of peace and subsequent continuing increase in oil revenues, but these have not lead to the formulation of a realistic domestic industrial promotion program based on a medium and long-term vision nor its expeditious implementation. On the financial and fiscal side, there are a few bright spots where under the strong guidance of the IMF, tightening and transparency of public expenditures has gradually taken effect, and the speed of foreign exchange depreciation and inflation has started to slowdown.

The government continues to clarify its regulation of oil revenue and appears to be working to improve the environment surrounding domestic industry by stabilizing the macro-economy over the short- and medium-term, restoring energy, communication and transportation infrastructures, as well as improving the legal system related to the economic activity (foreign investment) and its ability to execute those laws. As for the individual industries, the government's view is that it would like to, with the assistance of donor nations and institutions, promote the exploitation of undeveloped mineral resources; increase production of gas and oil; introduce more value-added products such as petrochemicals through the participation of foreign capital; open the agriculture industry to foreign and private capitals improving access to finance; enhance value-added and decrease losses with additional construction of refrigeration and processing areas for the fishing industry; and establish manufacturing clusters which will be available to produce products using domestic raw materials in order to fulfil local markets and advance import substitution in main regional core cities.

6.2.2 FDI Promoting Policies

Since the war formally ended in 2002, the Angolan authorities have been working on new economic legislation in a number of fields to transform many norms inherited from the early post-Marxist state period or even the post-revolutionary momentum of 1975. Their broad aims are bringing more foreign money into the economy, enhancing the skills of Angolan managerial workers, and giving a boost to local economic activity outside the oil sector. The projected new laws all mainly have a bearing on the operations of the international oil companies and their interaction with the Angolan economy.

Among bills under discussion, in the final stages of parliamentary discussion and publication in the official gazette, or already in force since late 2003, are those discussed below.

The legal package will be augmented by bills to be approved after spring 2005, dealing with the financial sector. It should also be noted that the laws are complemented by non-legal administrative procedures and initiatives, like the expansion of the fiscal and customs offices and bureaucracy to all national territory, the revamp of courts able to rule on fiscal/financial matters, the opening of technical courses in universities and high schools, the training of new public managers, etc.

In brief, the whole package has the following foundations:

- Poverty reduction and "human infrastructure rehabilitation", through the introduction of large scale industrial reform, and with the creation of professional training centres, destined to employ combatants returning to civilian life.

- Collection of more non-petroleum related taxes. Until now, oil related fiscal revenues accounted for 66.7% of all taxes collected. This in turn is included in the general need for simplification of the fiscal/tax system, in order to identify and generate more state revenues, without making the country less attractive to foreign enterprises.

(1) Private Investment Law

The ‘cornerstone’ of all the new and planned legislation is the Private Investment Law, passed after the end of the civil war. The *Angola Private Investment Law (PIL)* was published in the official journal (DR), 1st series, n.37. It is Law 11/03, from May 13, 2003. Some key aspects of this law include the following:

- The preamble recognises private investment as “crucial” to the development of the national economy. It also recognises that present legislation at the time should be revamped to offer more “guarantees” to domestic and foreign investors.
- It should be noted that article 2 considers a “national investor” as one that keeps its profits in Angola, independent of nationality. ANIP is defined as the responsible agency for investment matters.
- Article 3 defines “special investment modes” all input done in petroleum, diamonds and the banking/financial system. The state will determine, in special legislation, the exact framework for this.
- Article 4 defines general principles guiding investment. There are also references to “equality” between foreign and domestic investors, and the need to protect “the rights of economic citizenship of Angolan nationals”.
- Article 7 considers as “national investment operations” actions like acquisition of technology and know-how, machinery and equipments, creation of new firms, conversion of contractual credits, acquisition of real estate, exploration of agricultural concerns and hotels, etc.
- Article 9 defines “foreign investment operations”, including introduction in the national territory of freely converted foreign currency, introduction of technology, know-how, machinery and other fixed material goods, together with stocks and surpluses, acquisition of shares of Angolan companies, investment of financial resources resulting from foreign loans, joint ventures, creation of new companies belonging exclusively to the foreign investor, acquisition of real estate and buildings, investment in tourism and agriculture, etc. Art. 9, section 2, excludes from the definition of foreign investment the mere temporary rent, lease or loan of ships, planes or other means, and sec. 3 also excludes capital injection of less than US$100 thousand (not needing ANIP authorisation).

6.3. Incentives and Impediments for/to FDI

6.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

1) National Private Investment Agency (ANIP)

The body responsible for facilitating foreign investment in Angola is the National Private Investment Agency (ANIP - Agencia Nacional para o Invesimento Privado), which replaced the previous Foreign Investment Institute (IIE). It must be noted that ANIP handles both foreign and domestic investment, however, investments in the energy (oil), diamond, telecommunication and financial sectors continue to be governed by legislation specific to each sector. It is expected to become a one-stop-shop for investors. The Angolan government has taken the stance that both domestic and foreign investment need promoting equally, and that the two should be promoted so that Angolans do not 'lose out'.

ANIP must approve foreign investment between US$100,000 and US$5 million. Foreign investments less than US$100,000 do not require ANIP approval. The Council of Ministers must approve investments over $5 million, and any investment that requires a concession (such as oil or mining) or involves the participation of a parastatal. After obtaining contract approval from ANIP or the Council of Ministers, the investor must register the company, publish company statutes in the official gazette (Dairio de Republica), obtain a business license, and register with fiscal authorities.

ANIP also provides technical and legal assistance as well as conducting market studies for national and foreign investors to help identify investment opportunities. The new Private Investment Law not only reduces red tape but facilitates legal processes and provides a number of guarantees to private investors, such as guaranteed repatriation of capital

(2) Export processing Zones (EPZs) /Free Trade Zones

Currently, there are no foreign trade zones or free ports in Angola. However, in 2002, the Government of Angola established a bonded warehouse for basic foodstuffs where selected foreign exporters can deposit their products to sell directly to the Angolan market. The Government plans to expand this warehouse, Customs Warehouse of Angola (CWA), throughout the country.

(3) Privatisation

Privatization is still in its infancy in Angola, mainly because the country has just emerged from the war which ended in 2002. In terms of stated policy, Angola's government supports privatization, but sees the need to reserve 'strategic' areas for the government. Probably the most important developments regarding privatization and Public-Private Partnerships (PPPs) in Angola centre on infrastructure, namely the railways, harbours and telecommunications. At this point, the PPP issue is still being dealt with in a very ad-hoc manner, and there is no clearly defined set of rules and targets that the Angolan government has

(4) Incentives for FDI

The preamble to the Law of Development of Angolan Private Enterprise - Law 14/03 - makes it clear that its intentions are to 'level the playing field' between Angolan and foreign investors: "The State must create and make available the legal, material and institutional conditions allowing for the reduction of competitive disparities between national and foreign investors and at the same time encouraging synergies among private and public investors, following the principle of a more favourable or preferential treatment".

Angolans and Angolan companies gain access to a range of special privileges under this law, including tax incentives, credit and grant facilities. The state can also set aside contracts for local companies, and redirect revenue to them. Foreign investors can benefit from these incentives by engaging in joint ventures with Angolans and having the company defined as 'Angolan' through Angolan majority shareholding.

<u>1) Tax Exemptions/Tax Holidays</u>

Tax incentives are used to encourage investment in the priority sectors include farm production, manufacturing, fish and fish products, civil construction, health and education, and road, railroad, seaport, airport, telecommunications, energy and water infrastructure facilities. Tax incentives are also offered in accordance with the development zone (A, B or C) by which the country is divided. Investors may be exempted from taxes on capital investments for a 5-year period if they invest in zone A (where Angola's development is concentrated), 10 years for zone B, and 15 years for zone C (the least developed part of Angola). When acquiring land and real estate for the purposes of their projects, investors are also exempted from tax on the transfer of real-estate. Access to tax incentives is guaranteed for investments of at least US$50,000 domiciled in Angola, and at least US$100,000 dollars domiciled in other countries, regardless of the investor's nationality.

This class of investments includes priority sectors or zone C, projects that guarantee more than 10 job positions for Angolan nationals and new enterprises that will positively impact the region, including construction and or rehabilitation of economic or social infrastructure facilities.

In zone C, investments in new ventures as well as the rehabilitation of destroyed or stalled ventures will be exempted from the industrial tax for 10 years. This 10-year tax exemption will also be granted to investments in the food industry, farming, livestock husbandry and investments that create 50 or more job positions for Angolan nationals.

<u>2) Tariffs and Customs</u>

Law 17/03 - Law on Tax and Customs Incentives to Private Investment - governs the procedures, types and forms of concessions on tax and customs incentives within the scope of the Private Investment Base Law. Its objectives include promoting domestic manufacture (import replacement), development in needy areas, rehabilitation and modernization of infrastructure, technological innovation and improvement in the forex situation. Priority is given to the following sectors:

- Farming and cattle-breeding
- Processing industries
- Fishing and datives
- Civil construction
- Health and education
- Infrastructure (roads, rail, port, airport, telecommunications, energy and water)
- Heavy cargo and passenger equipment.

The tariff and customs incentives are also applied in accordance with three development zones. The incentives are best for Zone C and smallest in Zone A. Significant tax exemptions are provided for, and allowing a variety of costs to be tax deductions.

Angola has signed customs cooperation agreements with Portugal and Sao Tome and Principe, and is expected to sign others with South Africa and members of the Community of Portuguese Speaking States (CPLP). Angola is also currently negotiating with Namibia, Zambia and the Democratic

Republic of Congo, all fellow SADC members, to implement customs agreements. In March 2003, Angola agreed to adhere to the SADC Free Trade protocol that seeks to harmonize and reduce tariffs and by establishing regional policies on trade, customs, and methodology. In September 2004, the government announced reduced customs duties on imported goods and in December exempted entities in the enclave of Cabinda from all customs duties. These reductions and exemptions do not apply to the oil industry.

(5) Impediments to Attract FDI

Although the country has greatly streamlined the entire investment regime and established a 'one-stop' investor centre (ANIP), this has not properly overcome the major bureaucratic obstacles that have to be navigated in order to invest in Angola. ANIP and the various investment laws have changed the environment substantially, but there is a massive backlog of administrative inefficiency to overcome[63].

1) Corruption

It is crucial that companies seeking large contracts in Angola studiously avoid being sucked into openly corrupt practices. There are a number of case studies which show that this leaves behind a serious legacy, and can have very serious repercussions for future business. A new large venture may be forced into accepting a designated local partner, often fronting for someone in high office.

2) Centralized Decision-Making Structure

It is important to remember that in Angola there remains a highly centralized decision-making structure, despite all the progress made in liberalizing the economy. Large projects are routinely sent up from ministries for approval by the Council of Ministers, which ministries have quite limited authority to apportion large tenders or contracts. Requiring the Council's approval throws large projects directly into the political arena, and makes it all the more important to be aware of how the above centres of influence are layered.

3) Empowerment Policies

Angola does not have a local content law that currently imposes specific obligations on investors. Angola is, however, looking at 'empowerment' policies and regulations. In Angola this is referred to as 'Angolanization', and is applied to the level of share-holding and management[64], and not to local production versus imports. There is no formal discrimination against foreign investment, but Angolan companies or other companies familiar with the bureaucratic and legal complexities of the business environment often hold an advantage. Indeed, Angolan-owned companies can enjoy preferential treatment in tendering for goods, services and public works contracts. Foreign companies also complain that there is no clear coherent national framework; there is no overall coherence in measures adopted in this domain, decisions made today may be contradicted tomorrow.

4) Relations with IMF and World Bank

Angolan government remains unwilling to meet the IMF demands regarding governance and transparency issues. The troubled relations between Angola and the IMF and World Bank will continue to undermine the country's investment profile for some time to come. International donor community is therefore waiting for the time to start full-scale assistance, except for "restricted nations" including Russia, China, some other Asian and Arab countries.

[63] According to Price Waterhouse Coopers (PWC), the process of registering a new business in Angola takes 251 days, even with all the ANIP-related improvements.
[64] Decrees 5/95 and 6/01 limit expatriate staffing of local companies set up in Angola by national or foreign investors to no more than 30% of the workforce and requires Angolan and expatriate staff with the same job and responsibility to receive the same salary.

5) Accounting System

Angola's public and private companies have not traditionally used transparent accounting systems consistent with international norms. Few companies in Angola employ international audit standards. Effective in 2002, the Government is requiring "large" companies to undergo audits, but still lacks the capacity to enforce this new legal requirement.

6.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

The Angolan infrastructure system is governed by the relevant ministries, with secondary responsibility allocated to Provincial and city governments. At this point in time the Angolan infrastructure system is in what can be described as total collapse, primarily due to the destruction caused during the war, and decades of neglect. There are conflicting and overlapping oversights due to the unusual nature of Angolan governance, with many infrastructure development issues being taken out of the hand of relevant ministries and placed under the charge of the Council of Ministers or other ad-hoc groups, sometimes not defined in law or even announced. It is often said that this latter applies especially when there are ruling elite ‘special interests’ at stake. The President’s private foundation (A Fundação Eduardo dos Santos; FESA[65]), for example, has been regarded as a parallel social development structure, at one time spending more on basic services upgrading in Luanda than the government itself. It seems that Angola still need some more time to have a properly functioning set of oversight authorities.

Transport infrastructure is in disarray. Four main ports[66] are undergoing comprehensive restructuring. The country’s port facilities aim to play a major role in the SADC Region in improving import and export capabilities, particularly for its landlocked neighbours. Angola has 72,000km of roads, of which only 8,317 km are tarred. More than 60% of the tarred roads need repair. Although road rehabilitation and de-mining are long processes, there has been some progress allowing convoys to deliver goods to provincial areas. Regarding railway, only around 20%[67] is presently operating and considerable funds are required to bring them back to fully operational levels. The state media have announced that a US$4 billion project to rehabilitate Angolan railways over 11 years is already under way, partly with help from Chinese credit. The project involves not only the rehabilitation of three old lines[68] but also the construction of an undisclosed extra railway line, as well as several transversal sections (see the next heading), presumably linking the three existing east-west lines. Some railway bridges destroyed in the war have already been rebuilt following the start of rehabilitation by a Chinese firm. Due to the difficulty of overland travel, the most internal travel in Angola is by air. Almost all flights are heavily booked. The country has 243 airports of which only 32 are with paved runways.[69] Investment is needed for the rehabilitation of several airports and improvements to air traffic control systems to attain safety and reliable operations.

After years of civil war and the resultant destruction of infrastructure, the country’s power supply industry had damaged and being slowly rehabilitated.[70] The principal organisation responsible for the generation and supply of electricity in Angola is the State-owned Empresa Nacional de Electricidade

[65] FESA(http://www.fesa.og.ao/index.htm)

[66] Luanda, Lobito, Malongo and Namibe, of which three ports except Malongo deal with about 95% of total traffic of imorts. Luanda port has one of the finest natural harbours on the west coast of Africa and is now the most important port for the non-oil sectors of the economy.

[67] Railway track is 2,761km in total.

[68] Those are A) the 1,336-km Benguela railway, B) the 479-km Caminho de Ferro de Luanda railway, and C) the 907-km Moçamedes railway inland from the coastal town of Namibe. The Namibe and Benguela lines are forecasted to be operational within three years.

[69] CIA (2005) "the World Factbook-Angola-" (http://www.cia.gov/cia/publications/factbook/geos/ao.html)

[70] At present the country has approximately 500 megawatts of generating capacity. Electricity production in 2001 was 1.45 billion kWh.

(ENE). In addition, there are several privately-owned generating companies.

The civil war in Angola has led to the destruction of Angola's telecommunications infrastructure as well.[71] The government plans to invest in telecommunication infrastructure to increase coverage nationwide. Teledensity is very low[72] and its service is sporadic due to inadequate maintenance and repair. Angola Telecom is the licence holder for landline telecommunications in Angola. The telephone network is mainly limited to government and business use. But the cellular telephone system often cannot be accessed during business hours. Many large international companies have installed high frequency trunking systems to minimise use of the domestic telephone system. Upgrading the service whilst meeting soaring demands will require substantial imports of telecommunication equipments. One of the cellular service providers, Unitel alone invested US$100 million in 2004.

(2) Regional Programme

On February 4th 2005, the Namibian president, Hifikepunye Pohamba (predident-elect at the time) together with the former president Sam Nujomasaid on a visit to southern Angola that construction had begun on a railway line linking Angola to the Namibian railway network (which also links into the South African railway network). In addition, the rehabilitation of domestic railway lines is supposed to enable the country to link the other neighbours because the Benguela railway connects from Lobito to the eastern border with the Democratic Republic of Congo (and the line connects to Zambia from there.). Once completed, the rail link could have significant effects on regional trade. Once completed, the rail link could have significant effects on regional trade. Especially, the Benguela railway has high potentiality because the lines use to be the main mode of transportation for the copper exports from Zambia and Zaire.

(3) Trend in Privatisation and Some Observations on Current PPPs

Privatisation and PPPs scheme for infrastructure building and its service provision is not major in Angola. Only a few examples and plans are known at this time. The electricity generation is opened to the privately-owned generating companies. For the transportation, the government plans to privatise its State-owned shipping operations, which are all experiencing financial difficulties. Lastly, Portuguese Unitel provides cellar line services in communication. Although there are still limited in number of infrastructure projects that private sector involved, the PPIAF[73] (Public-Private infrastructure advisory facility) and the World Bank published the Country Framework Report for Angola on request from the government, in which the report aimed at improving the environment for private sector involvement in infrastructure.

6.3.3 Currency and Monetary Systems

(1) General conditions

Macroeconomics of Angola has been very unstable for a long period due to rampant inflation, overvaluation of its own currency, lack of investment to social infrastructure, etc.

The Government suffers an increasing fiscal deficit. In spite of tighter funds management through Ministry of Finance, Central Bank (Banco Nacional de Angola), state banks, there are still now problems to be resolved in statistics in international balance of payments and ODA loans. Petroleum export and infrastructure development are big factors in terms of national revenue and expenditure, respectively, to be taken into account. It is noteworthy that China has granted a line of credit amounting to 2 billion for infrastructure development.

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[71] There were 96,300 main fixed lines in use in 2003 and 130,000 cellular lines in use in 2002.
[72] According to the Background paper, 0.5 lines per 100 people.
[73] PPIAF is a multi-donor technical assistance facility aimed at helping developing countries to improve the quality of their infrastructure through private sector involvement. Japan is one of the contributors.

Financing the fiscal deficit not posted in government budget by Central Bank is the cause of a rapid increase of money supply and high rate of inflation in terms of monetary policy. Favourable export revenue may give room to Central Bank to intervene in exchange market for stabilization of kwanza, its national currency, but such policy seems not to be expected as the petroleum drops.

Other factors affecting the exchange rate are: budgetary expenditure, redemption of foreign loans, profit repatriation by petroleum companies, etc. The Government adopted a crawling peg system. A gradual depreciation of local currency is expected.

External debt of Angola amounts to about US$10.0 billion. It is financed by high-interest and short-term bonds in view of future petroleum production. About 40 % of the national budget is financed by these debts. Foreign reserve amounts to about US$375 million. The Government is negotiating a debt restructuring with such countries including Portugal, Germany through bilateral agreements and outside the framework of Paris Club.

Export of Kwanza is prohibited and carrying out of foreign currency is generally limited to US$5,000. By a BNA Order of April 2003, repatriation of dividend or transfer of funds overseas is more rigidly controlled.

There is neither foreign portfolio investment, nor stock market in Angola. The Government makes efforts to develop a secondary market for bonds issued by the Central Bank called “Titulos do Banco Central”. The Government authorized the Finance Ministry to issue Titulos in order to stimulate money supply more effectively and to control debts, but applicable laws and regulations are yet to be enacted. The Government has budgeted US$ 1 billion for bonds to pay its debt to banks or use them as collateral for credit. The Government also announced plans to develop a stock market in early 2004, but has not moved forward with this project.

(2) Banking sector

Angola's financial sector, though still underdeveloped, has grown rapidly. As of June 2004, total assets of the banking sector reached US$ 3.5 billion (US$ 2.6 billion in deposits), up from US$ 2.1 billion in 2002. Most banks focus their operations on short-term commission-related activities such as currency trading and trade finance. Foreign investors do not normally access credit locally, and local investors either self-finance or seek financing from non-Angolan banks and investment funds. Subsidized government loan programs to promote economic development are available only to majority-owned Angolan companies and on a very selective basis. Local businesspeople must take loans in kwanzas, the Angolan currency, though exceptions are granted. Kwanza-based loans have interest rates ranging from 60-70% to compensate for inflation, whereas interest rates for dollar-indexed loans are generally below 10%.

Banks have avoided lending due to a lack of collateral, a weak judicial system, and poor tracking of credit histories and other necessary financial information. Because state and state-affiliated companies enjoy privileged access to loans, often at concessionary rates, there has been a high rate of bankruptcy. Currently, the banking sector's non-performing loan rate is about 5 to 7%. Legislative changes and development in the banking sector are producing dramatic improvements. The new land law should reduce confusion over property rights and help identify sources of collateral. The central bank is working to improve its credit database. In the beginning of 2005, the central bank will present a new financial sector law that clarifies banking oversight and regulations and facilitates the establishment of microcredit institutions. As a testament to improving conditions, the percentage of deposits lent out as credit has grown from 30 to 70% over the past three years and several Portuguese and South African banks are opening new branches.

Past triple-digit inflation resulted in a high level of dollarization in the banking system and in Angola's economy overall. Since the end of civil war, the central bank has devoted considerable effort to rebuilding trust in the kwanza and controlling inflation, which fell to 30% for 2004. Currently some commercial banks still hold as much as 80% of their assets in Kwanzas. Central bank regulations limit banks to keeping only 20% of their reserves in foreign currency. The mandatory reserve requirement for non-government deposits, whether in kwanza or foreign currency, is 15%.

Financial sector is predominated by 7 commercial banks, 1 investment bank and 3 agencies of foreign banks. Out of 7 commercial banks, three are of foreign capitals (Banco Espirito Santo, Banco Totta de Angola (BTA), Banco Comercial Portugues (BCP), and three are of Angolan capital (Banco Africano de Investimento (BAI), Banco de Fomento Exterior (BFE), Angolan Commercial Bank (BCA)). Of these Angolan banks two are state-owned and own 45% of total assets of commercial banks. In addition, there are two more state-owned banks (Bank of Commerce and Industry (BCI) , Bank of Saving and Credit (BPC))with a view towards eventual privatization. Initial steps to privatize BCI were taken, while the government decided no to privatize BPC. In 1997, BNA, Angolan central bank which had played a role of commercial bank, abandoned the commercial bank's role, and was specialized in central bank's business.

(3) Foreign Exchange Controls

The major exchange control regulations are as follows:

- No restrictions exist on the amount of foreign currency brought into Angola, but the exportation of domestic currency is prohibited;
- There are specific dealers in Angola who are authorised to buy and sell foreign exchange;
- Travel allowances, allowances for medical treatment abroad, and allowances for dependants overseas, are all granted at fixed monthly rates;
- Dividends earned by foreign investors may be taken out of Angola if the investment in the resident company exceeds US$250,000;
- Transfers of personal capital are reviewed on a case-by-case basis; and
- Foreign currency accounts are permitted, into which foreign currency (in cash, travellers cheques or foreign payment orders) may be deposited.

Although economic and financial reform measures in recent years have improved local access to foreign exchange and facilitated remitting and transferring funds, Central Bank (BNA) Order 4/2003 imposes stricter controls over transfer of funds abroad. While Investment Law 11/03 does guarantee the repatriation of profits for officially approved foreign investment and investors can remit funds through local commercial banks, under Order 4/2003, the BNA must now first authorize the repatriation of profits and dividends. In addition, the BNA can temporarily suspend repatriation of dividends or impose a regime of repatriation in instalments if immediate repatriation will have an adverse effect on the country's balance of payments. Companies have complained about waiting several months to remit funds abroad, but banks have recently improved average service time to less than 24 hours.

Under the terms and conditions established by the Currency Exchange Law investors can transfer distributed dividends and profits abroad after deducting legal amortizations and taxes due on them, in accordance with their respective shares in the equity of the corporation or business entity. They can also transfer the results of the liquidation of their investments (after paying any taxes owed), the results of compensations, royalties or other revenue obtained from indirect investments associated with technology transfer. Investors may also transfer any amounts owed them as stipulated in private investment agreements, following the deduction of any taxes due on them. Investments in diamonds, petroleum and Financial Institutions are covered by specific legislation.

6.3.4 Labor and Management

The skills base of the local labour force is generally limited, and there is a severe shortage of workers with good managerial or technical skills. Employers are actively training Angolan staff on the job. The

English language capability of most workers is still in low level.

The government has announced but not yet implemented a new regulation requiring oil companies to hire Angolan nationals if qualified applicants are available. If there are no qualified nationals for the position, companies may request permission from the government to hire expatriates. Not more than 30% of the workforce within a company can be expatriates. The rule will also require equal pay and benefits between nationals and expatriates. However no date for implementation of the above mentioned regulation has been established.

6.4. Official Development Assistance (ODA)

6.4.1 Overview of assistance by donors and international organizations

Despite substantial and varied natural resources, Angola remains one of the poorest countries in the world. Angola has been clamouring for an international donor's conference for the past three years, since the end of the civil war in 2002. However, the donor community as a matter of principle considers that a donor conference cannot be organized before Angola has concluded a formal agreement with the IMF. The IMF's "seal of approval" of a beneficial country's economic and financial policies is considered by aid agencies as a necessary guarantee to ensure that aid money will be well spent. More generally, most donors are unable to reopen their development aid, as opposed to emergency aid, until Angola has cleared its heavy arrears on past loans. An IMF agreement is also considered as a prerequisite for a renegotiation of Angolan debt to official creditors in the Paris Club, seen as a significant step towards restoring "normal" relations with the international financial community.

Angola has drafted the PRSP in 2002 and the Angola government and the donors have been coordinating its contents. Below is an overview of the assistance by major donors. However, in recent years, China, Brazil, Germany, Portugal and the US have been listed as the main bilateral donors.

Table 6.6: Economic Cooperation towards Angola by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	United States 28.8	United States 48.1	United States 37.3	United States 34.0	United States 105.6
2nd	Spain 25.2	Spain 35.8	Japan 21.5	Japan 20.7	Holland 27.7
3rd	Portugal 23.9	Italy 25.0	Sweden 17.1	Holland 20.5	Japan 27.2
4th	Norway 23.1	Japan 22.0	Norway 16.6	Norway 17.5	Norway 22.2
5th	Sweden 22.5	Portugal 19.8	Spain 16.2	Sweden 13.4	Germany 16.5
Japan	17.9	22.0	21.5	20.7	27.2
Total	214.5	251.8	189.1	179.4	286.4

Source: Compiled by MOFA Japan from OECD/DAC

6.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

Since 2000, Japan has focused on the following four areas: 1) healthcare; 2) basic infrastructure; 3) agriculture; and 4) reconstruction efforts. Below is an overview of Japan's ODA to Angola. In the form of grants, Japan has assisted Angola in the areas of food assistance, hospital provisions, and resettlement programs for refugees in collaboration with the UNHCR and the prevention program of infectious diseases for children through UNICEF. In addition, Japan has provided technical assistances such as accepting trainees in the areas of healthcare, basic infrastructure and agriculture.

Table 6.7: Recent ODA to Angola

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-	18.20	2.51	20.71
2002	-	26.09	1.13	27.21
2003	-	32.66	0.44	33.10
Cumulative Total	-0.32	145.54	17.60	162.79

Source: Compiled by MOFA from OECD/DAC

(2) United States

The US national interests in Angola are socioeconomic, humanitarian, and political. The US seeks to assist Angola in its economic rehabilitation, effective national reconciliation, resettlement and reintegration of war-affected populations, reconstruction of crucial infrastructure, and the establishment of democratic and free market economic processes. For the US, Angola is the eighth largest supplier of oil and is one of the United States' largest trading partners in Africa.

USAID has provided assistance in the creation of Financial Planning Unit, to promote a system of transparency of government revenues and public enterprises. In addition, USAID has provided assistance in areas such as micro-credit program, AGOA promotion, privatization promotion and corruption mitigation.

USAID has also been operating a new initiative, the Global Development Alliance (GDA). GDA attempts to mobilize the ideas, efforts and resources of governments, businesses and civil society by forging public-private alliances to stimulate economic growth, develop businesses and workforces, address health and environmental issues, and expand access to education and technology. In 2002, a $20 million USAID and Chevron Texaco announced a public-private alliance to provide support and training for enterprise development in Angola. The alliance is part of the US$50 million commitment to Angola over five years by Chevron Texaco/USAID, UNDP, and other partners.

(3) China

China has grown to become one of the major creditors of Angola even though the true extent to this is unclear as such information is not disclosed by China. The agreement with China's Exim Bank for a US$2 billion US$ loan was signed in spring 2005 and has not yet been fully disbursed. The loan is to be used to finance infrastructure rehabilitation and construction, including repairs of railways and other communication links destroyed during the civil war. These projects are mainly operated by Chinese engineers. This huge loan was reportedly granted on concessional terms and bears some resemblance to the oil-back commercial bank loans, that is, repayments will be in the form of crude oil deliveries over a period of 18 years[74].

(4) World Bank

The World Bank assistance began in 1991 with a credit from the IDA for economic management capacity building. The World Bank has established a Country Office in Luanda from which country dialogue and project oversight take place. IDA's assistance strategy is set out in the Interim Strategy Note (ISN)[75] for 2005 and 2006 is based on three pillars: 1) enhancing the transparency, efficiency and credibility of public resource management; 2) expanding service delivery to war-affected and vulnerable groups; and 3) preparing the ground for broad-based equity (pro-poor) economic growth.

[74] Based on information gathered by the ERA.

[75] Countries in transition from conflict like Angola do not have a Country Assistance Strategy (CAS), but instead prepare the ISN, which is a short to medium-term plan for the World Bank involvement in the country. The ISN sets out IDA's program of assistance in terms of preparation of potential future projects and areas of research.

The ISN has a strong focus on economic and sector work, particularly with respect to economic advisory services, for example, the climate for private sector investment and technical assistance. In addition, IDA hopes to support a Donor Consultative Group (CG) meeting to facilitate coordination among donors working in Angola. IDA is now operating a US$16.6 million Economic Management Technical Assistance Project.

The IFC has made two major investments in Angola, in a bank (Novobanco Enterprise Bank of Angola S.A.R.L) targeting SMEs and in Angola's first private insurance company (Noba Sociedade de Seguros de Angola S.A.R.L. (Nossa)). IFC has also provided technical assistance to private enterprises in Angola.

7. MOZAMBIQUE

7.1. Trends of Macro Economy, Industry, Trade and Industry

7.1.1 Macro Economy

At independence in 1975, Mozambique was one of the world's poorest countries. Socialist mismanagement and a brutal civil war from 1977-92 exacerbated the situation. In 1987, the government embarked on a series of macroeconomic reforms designed to stabilize the economy. These steps, combined with donor assistance and the existence of political stability since the multi-party elections in 1994, led to a dramatic improvements in the country's growth rate, spurred on by large inflows of foreign investment. Inflation was reduced to single digits during the late 1990s, and although it returned to double digits in 2000-03, dropped back to single figures in 2005. Fiscal reforms, including the introduction of a value-added tax (VAT) and reform of the customs service, have improved the government's revenue collection abilities.

Mozambique’s macro-economic reforms and success in attracting large investment projects resulted in an average GDP growth rate of over 8% from 1992-2004, the highest in Africa over this time period. FDI, exports, and revenue collections have seen notable increases and privatization continues, but has slowed in recent years. The Heavily Indebted Poor Countries (HIPC) and Enhanced HIPC debt relief programs have permitted increased budgetary support for efforts to alleviate absolute poverty. GDP growth for 2003 was approximately 7%, and the government expects the economy to continue expanding at a rate between 7-10% over the next few years.

Maintaining this high level of growth will hinge on several major foreign investment projects, continued economic reform, revival of the agriculture and transportation, and tourism sectors. This growth has been from a low base; per capita GNP for 2002 was just US$200. Meeting the human and infrastructure demands of investment remains a challenge.

Table 7.1: Major Macroeconomic Data

	1960s	1970s	1980s	1990s	1998	1999	2000	2001	2002	2003
Population (million)	8.5	10.7	13.5	16.0	17.0	17.3	17.7	18.1	18.4	18.8
Population ages 0-14 (% of total)	42.2	43.6	43.8	45.3	44.6	43.9	43.1	42.8	42.5	42.3
Population ages 15-64 (% of total)	54.8	53.3	53.0	50.8	51.4	52.3	53.2	53.5	53.8	54.1
Population ages 65 and above (% of total)	3.0	3.1	3.2	3.9	3.9	3.8	3.7	3.7	3.7	3.6
GDP (constant million 2000 US$)	-	2,111.7	1,899.8	2,787.6	3,375.1	3,629.5	3,684.7	4,163.7	4,471.8	4,789.3
GDP growth (annual %)	-	-	0.5	5.7	12.6	7.5	1.5	13.0	7.4	7.1
GDP per capita (constant 2000 US$)	-	174.6	141.3	172.5	198.9	209.8	208.3	230.4	242.5	254.9
Official exchange rate (LCU per US$, period average)	28.8	29.3	272.9	8,560.3	11,875.0	12,775.0	15,227.0	20,704.0	23,678.0	23,782.0
Inflation, consumer prices (annual %)	-	-	9.3	31.1	1.5	2.9	12.7	9.1	16.8	13.4
Money and quasi money (M2) as % of GDP	-	-	31.6	22.5	19.4	21.9	27.1	28.7	29.8	29.5
Real interest rate (%)	-	-		15.1	18.9	16.3	10.2	11.0	13.6	10.7
Foreign direct investment, net inflows (% of GDP)	-	0.0	0.1	3.1	5.5	9.6	3.8	7.4	9.7	7.8
Foreign direct investment, net inflows (% of gross capital formation)	-	0.0	0.5	10.8	22.7	26.1	10.3	23.2	31.9	27.9
Agriculture, value added (% of GDP)	-	37.1	39.7	32.8	32.9	30.9	26.8	26.7	26.6	26.1
Industry, value added (% of GDP)	-	34.4	23.2	20.8	23.4	24.5	26.6	27.6	28.9	31.2
Manufacturing, value added (% of GDP)	-	-	10.2	10.1	11.9	12.7	13.4	15.3	14.9	15.5
Services, etc., value added (% of GDP)	-	28.5	37.2	46.4	43.6	44.7	46.5	45.7	44.6	42.8
General government final consumption expenditure (% of GDP)	-	12.2	14.0	11.2	10.4	9.5	10.4	10.8	11.0	11.5
Household final consumption expenditure, etc. (% of GDP)	-	96.7	91.9	88.6	82.8	81.5	79.1	70.9	73.4	77.3
Final consumption expenditure (% of GDP)	-	108.9	105.9	99.8	93.2	91.0	89.4	81.7	84.4	88.7
Gross capital formation (% of GDP)	-	7.6	13.6	27.0	24.2	36.7	36.6	32.0	30.3	27.9
Exports of goods and services (% of GDP)	-	10.9	6.5	12.4	10.5	10.1	12.9	21.8	23.5	22.8
Imports of goods and services (% of GDP)	-	27.4	26.0	39.2	27.9	37.8	38.9	35.4	38.2	39.4
Gross domestic savings (% of GDP)	-	-8.9	-5.9	0.2	6.8	9.0	10.6	18.3	15.6	11.3
Gross capital formation (% of GDP)	-	7.6	13.6	27.0	24.2	36.7	36.6	32.0	30.3	27.9
Food exports (% of merchandise exports)	-	-	-	65.1	-	52.0	-	22.9	-	-
Food imports (% of merchandise imports)	-	-	-	21.5	-	-	-	14.0	-	-
Agricultural raw materials exports (% of merchandise exports)	-	-	-	12.1	-	11.1	-	4.2	-	-

Agricultural raw materials imports (% of merchandise imports)	-	-	-	2.1	-	-	-	1.3	-	-
Ores and metals exports (% of merchandise exports)	-	-	-	2.4	-	1.7	-	54.9	-	-
Ores and metals imports (% of merchandise imports)	-	-	-	0.9	-	-	-	0.3	-	-
Fuel exports (% of merchandise exports)	-	-	-	7.6	-	25.2	-	9.5	-	-
Fuel imports (% of merchandise imports)	-	-	-	11.8	-	-	-	15.9	-	-
Manufactures exports (% of merchandise exports)	-	-	-	12.6	-	10.1	-	7.5	-	-
Manufactures imports (% of merchandise imports)	-	-	-	62.4	-	-	-	46.7	-	-
Aid per capita (current US$)	0.4	5.1	36.0	66.7	61.3	46.5	49.6	51.6	111.4	55.0
Total debt service (% of exports of goods and services)	-	-	29.0	23.6	18.0	16.8	11.7	8.5	6.9	6.9
Total reserves in months of imports	-	-	1.6	3.4	5.7	4.7	5.1	4.6	4.2	6.1

The World Bank (2005), *World Development Indicators: 2005*

7.1.2 Industry

A long civil war had continued between the government and anti-government forces since independence in 1975, impoverishing the domestic economy and industry. However, after the comprehensive peace agreement in 1992, strengthening economic ties and infrastructure with South Africa, which has returned to the international community, and increasing aid designated to the post-conflict country allowed the nation to establish the necessary environment for economic growth and domestic socio-political stability. In 2000, MOZAL, the world's largest aluminum smelter, commenced operations. Not only has it created jobs during its construction phase and dramatically increased foreign currency earnings after operation, but it has also attracted attention internationally as a new model of mega project realized trough FDI in Southern Africa. The success of this project is expected to spark the interest of foreign investors in Mozambique and to induce next series of similar FDI in other countries of the region.

Taking a look at changes in the composition of GDP in Mozambique, the ratio of agriculture and fishing declined from 37% in 1990 to 23% in 2002, and that for mining and manufacturing rose from 18% to 34% (of this manufacturing accounted for 13%). The start of the above-mentioned MOZAL Project is thought to have driven the latter ratio up significantly. There was no change in the service industry ratio at 43%.

The agriculture, the sector with the largest employment and eminent potentiality for development, is blessed with rainfall, and a water supply from the Zambezi River, and thus has a large cultivable area, 4 million hectares, which is quite extensive even within the region. The principal products are self-sufficiency crops such as maize, rice, pulse, vegetables and cassava (tapioca). Although there are a rich variety of cash crops including cashew nuts, sugarcane, sisal, cotton, citrus and tropical fruits, tea and tobacco, the amounts produced and exported are small. After the rapid increase in the number of individual small farmers following the abolishment of the government’s agriculture land monopoly, food self-sufficiency is continuing to be achieved. Recently, export to neighboring South Africa and Zimbabwe have expanded based on the commercial production of cash crops. The fishery industry is mostly undertaken by small-scale fisherman, but South African, European and Japanese fishery companies have also obtained operating rights, and catch amounts have been increasing every year. The main products are shrimp, lobster and coastal fish. In inland lakes, such as Lake Cahora Bassa, freshwater sardines are also harvested. Most of the fishery products caught is unprocessed and designated for export or domestic consumption.

In the mining sector, various mineral resource deposits have been confirmed, such as gold, titanium, tantalum, precious stones, and bauxite. However, most of these, except for gold, tantalum and the mining of precious stones by small businesses, are undeveloped. Blessed with the increasing demand in international market, European companies have recently obtained the right to develop titanium and other development projects are expected in the near future. In regard to hydrocarbon resources, construction of a pipeline toward South Africa and the development of gas fields have been completed. The development of coalmines is also schedule to proceed, which will likely contribute to an accumulation of foreign currency earnings after 2005. In the manufacturing sector, construction of the second phase of MOZAL has been completed, and aluminums production has doubled to 500 thousand tons per year (in 2004). Mining and metal processing industry will maintain a tractive force of the economic growth. In other industries, there is a limited construction industry along with some small production of garments, food and drinks as well as construction materials destined for domestic markets mainly in urban areas such as the capital of Maputo.

In regard to the service sector, transit trade and transportation of goods to neighboring Zimbabwe has slumped due to the nation's economic impoverishment, but the telecommunications sector is growing with the expansion of cellular phone service, which has been utilized as an opportunity for the emergence of foreign investment. Additionally, the revitalization of foreign trade has spurred the demand for hotels and increased also the number of tourists. Revenue from tourism in 2002 climbed to US$140 million dollars, and there has been a remarkable influx of FDI mainly from South African capital.

7.1.3 Trade and Investment

(1) Trade

Following the establishment of the Mozal aluminium smelter, the composition of Mozambique's export has changed from which had been dominated by fisheries and traditional agricultural products, such as cotton and cashew nuts. Aluminium has become the principle export product since 2001, and shares more than half of export, followed by prawns and electricity.

A substantial trade imbalance however persists although the opening of the Mozal. Additional investment projects in titanium extraction and processing and garment manufacturing should further improve the balance of trade, however, strong increase in imports of capital equipment for the realization of such projects would have the possibility to further deteriorate trade imbalance.

Aside from aluminium, electricity, prawn and traditional agricultural products, some other products have the potential to make a significant contribution to exports. Copra, tea and tobacco are included, but still stagnant. Sugar has great potential with sugar exporters to benefit from the United States of America quota allocations and also from the liberalization of the European Union's trade regime applicable to least developed countries. Exports of manufactured goods, which account for more than 10 percent of total exports, have performed well in recent years. Textiles, tyres and processed raw materials drive the sector.

Although imports from Portuguese still represent a certain amount, trade with other African countries has increased in recent years. South Africa and Zimbabwe are significant markets for Mozambican exports, and South Africa is also the dominant foreign supplier of Mozambican imports.

Table 7.2: Trade tendency and main partners

（US$ million）

			1998	1999	2000	2001	2002
Export			407	403	474	747	846
Import			1,081	1,505	1,433	1,218	1,376
Main trading partners							
	Export	South Africa	40.10	71.00	53.35	107.64	116.81
		Zimbabwe	43.10	40.20	64.54	37.15	40.31
		Spain	37.90	34.50	39.05	26.97	43.58
	Import	South Africa	317.20	302.10	520.59	389.07	422.25
		Portuguese	64.00	42.90	79.88	81.12	56.09
		United States	40.40	44.40	36.24	17.25	107.80

Source：World Bank, *World Development Indicators*; IMF, *Direction of Trade Statistics*

(2) Foreign Direct Investment

Mozambique's Investment Promotion Centre (CPI) states that from January 1, 1990 through

December 31, 2003, a total of 1,852 projects were approved under the country's law of investments, creating an estimated 225,835 jobs and totaling US$13 billion in investment. Foreign direct investment accounts for US$3.3 billion of this amount, US$872 million represents national direct investment, and the remainder is financed through loans, reinvestments, and subsidies.

Table 7.3: FDI Inflow

（US$ million）

1998	1999	2000	2001	2002	2003
234.9	381.7	139.2	255.4	155.3	336.7

Source: UNCTAD, FDI On-line.

Investments were made in industry (US$1,7 billion), minerals and energy (US$631 million), agriculture and agro-industry (US$260 million), banking and insurance (US$237 million), and tourism and hotels ($209 million).

During 2003, CPI approved 101 projects involving foreign investment, with FDI valued at approximately US$122 million. These numbers do not include FDI from Australia for the Limpopo Corridor Sands project or FDI from Ireland for the Moma heavy sands project, both of which are slated to begin in 2005-2006.

Table 7.4: The top ten sources of FDI in 2003

Country	No of Projects	FDI in Millions of USD
Mauritius	4	61.25
South Africa	30	26.63
UK	13	11.42
Portugal	8	5.07
Libya	2	4.64
United States	2	2.20
Canada	2	1.38
Bulgaria	1	1.38
China	3	1.35
Denmark	1	1.25

Source: CPI

Table 7.5: Investment Approved for Sectors for year 2003

Sector	No of Projects	Value (USD)				Jobs/work	
		IDE*	IDN**	Total	%	No	%
Agriculture and Agro-Industries	24	26,110,086	2,381,999	62,008,123	7.14	5,136	37.58
Agriculture and Fisheries	9	3,045,000	1,648,827	25,505,196	2.94	656	4.80
Banks and Insurers	1	70,000	5,000	75,000	0.01	12	0,09
Constructions and Public Works	3	3,690,225	1,250,000	7,450,405	0,86	510	3.73
Industries	27	8,878,516	10,541,152	40,148,234	4.63	1,408	10.30
Resource Minerals	1	4,230,134	4,370,773	10,260,907	1.18	27	0.20
Transport and Communications	5	60,546,760	1,340,521	570,371,373	65.71	638	4.67
Tourism and Hotels	16	11,129,256	5,234,794	31,446,289	3.62	588	4.30
Other	26	4,343,176	7,680,746	120,729,227	13.91	4,700	34.37
Total	112	122,043,153	34,453,812	867,994,754	100	13,675	100

* Foreign Direct Investment ** Local Investment

Source: CPI

The following data details total approved investment for specific projects in 2003. Data is included for projects that CPI considers to be in the implementation phase or operational.

Table 7.6: Total approved investments 2003

Company	Sector	Amount Invested
Vodacom Mozambique, S.A.R.L.	Transport & Communications	$ 58 800 000
Cane Farming and Sugar Bagging	Agriculture & Agro-Industry	$ 14 214 286
Unagi Moçambique	Agriculture & Agro-Industry	$ 8 000 000
Petrogás	Mineral Resources & Energy	$ 4 230 134
Sociedade Saboeira de Nacala	Industry	$ 4 141 178
Lighthouse Resort	Tourism & Hospitality	$ 3 400 000
C.L.M. Moçambique	Other	$ 2 461 990
Cerâmica de Umpala	Construction	$ 2 390225
Indian Ocean Aquaculture	Aquaculture & Fishing	$ 1 995 000
Companhia Nacional Algodoeira	Agriculture & Agro-Industry	$ 1 925 000

Source: CPI

In 2004 some 143 projects were approved, totalling US$508 million (this includes FDI, foreign loans, and national private investment). The sectors with the greatest level of investment were: transportation and communications, tourism and the hotel industry, and agriculture and agro-processing.

Of the 143 projects approved in 2004, 105 of them involved foreign investment valued at approximately US$ 122 million in total. The breakdown of FDI by country of origin is as follows:

Table 7.7: Origin of Foreign Direct Investment 2004

No	Country	Projects	IDE (US$)
1	South Africa	42	58 562 868
2	UK	16	13 167 437
3	India	2	10 179 062
4	Portugal	14	5 604 362
5	Yugoslavia	1	5 000 000
6	Malawi	4	4 806 249
7	Zimbabwe	23	4 661 286
8	Mauritius	2	2 766 200
9	Switzerland	3	2 483 875
10	Tanzania	2	2 193 436
11	Lebanon	3	1750 000
12	Qatar	1	1 655 500
13	France	4	1 425 000
14	Holland	4	1 130 833
15	Denmark	2	1 050 000
16	Italy	1	960.000
17	UAE	4	861 964
18	Austria	1	773 276
19	Singapore	3	663 062
20	Greece	1	50 000
21	Germany	1	498 750
22	Ireland	2	399 075
23	Bahamas	1	355 000
24	Spain	1	300 000
25	China	2	292 000
26	Poland	1	180 000
27	Zambia	1	138 625
28	Brazil	1	83 333
29	Norway	1	75 000
30	Swaziland	1	63 636

31	Libya	1	50 000
32	Uganda	1	50 000
33	Panama	1	50 000
Total			122 729 829

Source: CPI, May 2005

Table 7.8: Investment approved for Sectors in 2004

	No.	Jobs	IDE US$	IDN US$	Loans US$	Total US$
Agriculture and Agro-Industries	34	2 981	18 903 302	10 336 649	76 877 234	106 117 785
Agriculture and Fisheries	8	628	8 624 500	435 453	16 000 000	25 059 953
Banks and Insurers						
Constructions and Public Works	4	113	1 603 234	601 185	3 421 394	5 625 813
Industries	41	5 584	15 110 324	6 976 464	20 73918	42 826 706
Resource Minerals	4	108	1 610 000	370 208	4 745 000	6 725 208
Transport and Communications	8	1 232	22 046 634	11 813 825	133 133 333	166 993 792
Tourism and Hotels	22	1 770	50 701 016	5 562 553	65 569 876	124 833 445
Other	24	801	4 130 822	8 641 975	18 421 591	31 194 388
Total [US$]	145	13 271	122 729 832	44 738 312	341 908 346	509 376 490

Source: CPI May 2005.

Investment statistics from 2004 forward will need to take into account several new, large projects that are currently under way or have been announced, such as the coming on stream of the US$2.2 billion SASOL Pande natural gas pipeline; the heavy sands extraction and processing (Moma Heavy Sands Project by Kenmare Resources - Ireland and Corridor Sands by WMC - Australia), and the Moatize mining project (Companhia do Rio Vale Doce - Brazil). These multi-million dollar projects will be spread over several years before their implementation is complete.

In the first six months of 2005, the UK overtook South Africa as the top foreign source of foreign direct investment in Mozambique after South Africa had held onto the rank for several years. Investment totalling US$26.4 million from the UK was approved, pushing South Africa down to second place with just over US$16.4 million dollars.

(3) Top Company Profiles

A report compiled by KPMG in 2004 on the Top 100 Companies in Mozambique, provides the most comprehensive overview or “aggregate analysis”, available on relevant background material (mainly revenues) on each company in the country. In this respect Mozal takes top spot, comfortably beating Hydroelectric of Cahora Bassa (HCB) into second place.

A sectoral breakdown of the Top 100 Companies operations, reveal that 57% operate in the trade area, 19.9%in tourism and hospitality, 10.4% in the processing industry, 2.2% in the agricultural industry and the remaining sectors displaying an individual weighting of less than one percent.

The nationality profile of the country’s top 10 companies is as follows:

1) Mozal	(BHP-Billiton, South Africa/Australia)
2) HCB	(Portugal/Mozambique)
3) Petromac-Petroleum	(Mozambique)
4) TDM-Telecommunications	(Mozambique)
5) EDM-Electricity	(Mozambique)
6) M-Cel	(Mozambique)
7) BP-Mozambique	(BP-Amoco, United Kingdom)

8) Cervejas de Mozambique	(SAM Miller, South Africa)
9) CFM-Portos e Cam de Ferro de Moz	(Mozambique)
10)Motraco	(Eskom {South Africa}, EDM {Mozambique} and Swaziland Electricity Board (SEB))

7.2. Policy Issues Promoting FDI

7.2.1 Industrial Policies and Development Plans

With the collapse of the former Soviet Union and the end of civil war, the government has shifted course from a socialist planning economy to a market oriented one, and has adopted policies linked to overall promotion of foreign investment and fostering of the private sector introducing necessary measures such as privatization of public enterprises and liberalization of principal domestic market. Also, Industrial Free Zones (IFZ) have been set up in areas adjacent to major ports to attract foreign investment, and preferential measures such as a variety of tax incentives are being granted. In the agricultural sector, foreign capital and technology from countries such as Zimbabwe has flown in. Also, with improvements in the irrigation and transportation infrastructure, attempts are being made to improve productivity and product diversification. The fishing industry has taken up the particular task of encouraging aquaculture industries that concentrate on raising the mainstay of shellfish. In the manufacturing field, emphasis is being placed on the development of a food-processing industry, which will tie up with the promotion of agriculture and marine products as well as advancing the several "Corridor Plans," becoming the key to developing the domestic infrastructure and an economic bloc with the surrounding nations. As for the service sector, it seems that the government put focus on the improvement of a financial sector necessary for facilitating the raising of funds, and development of tourism related infrastructure where high potential exists.

7.2.2 FDI Promoting Policies

Mozambique has emerged from its conflict-torn past to become one of the more dynamic economies in Sub-Saharan Africa. In the past, political risk, corruption, bureaucratic red tape, dilapidated infrastructure, and the relatively small size of the market served as strong deterrents to foreign investment. While these issues have not been entirely resolved, they have improved markedly. In particular, the Government’s policy of granting management concessions and privatising part of their transportation network is paying dividends in creating a more trade friendly environment.

The Government considers the following as the 10 main objectives to be gained by the Mozambican economy from both foreign and national direct investment:

- Development, rehabilitation, modernisation or expansion of economic infrastructures for operation of productive activities or rendering services;
- Expansion and improvement of national production capacity or the capacity to render services;
- Contributing to the formation, multiplication, and development of national entrepreneurs and Mozambican business partners;
- Creation of jobs for national workers and raising professional skill levels of the Mozambican labour force;
- Promotion of technological development and improvement of entrepreneurial productivity and efficiency;
- The increase and diversification of exports;
- Rendering of productive services and/or those services generating foreign currency;
- Reduction and substitution of imports;
- Contribution to the improvement of the local market supply and to satisfying the population's priority and basic needs; and

- Direct or indirect contribution towards improving the balance of payments and the Government Budget revenue.

A comprehensive overview of initiatives, policies and special benefits for investors are found in the CPI handbook entitled "Legislation on Investment in Mozambique". Greater incentives are given for investment in new or "paralysed undertakings" (non-operational companies) selected in more under-developed regions. Companies can benefit by an offered "Reduction of Industrial Contribution Tax" and "Supplementary Tax" during the period of investment recovery (up to ten fiscal years) by:

- 80% for investments carried out in Niassa, Tete, and Cabo Delgado Provinces;
- 65% for investments carried out in other provinces, outside the respective capitals; and
- 59% for investments carried out in the provincial capitals.

In addition, supplementary benefits for investments in less developed areas (for investments in new or paralyzed undertakings) can enjoy and extended reduction of industrial contribution tax by:

- 50% for further six years in Niassa, Tete, and Cabo Delgado (including the provincial capitals);
- 40% for further three years in Nampula, Zambézia, Manica, and Sofala (excluding the provincial capitals); and
- 25% for further three years in Inhambane, Gaza, and Maputo (excludingthe provincial capitals).

Attracting investments to traditionally underdeveloped regions in the north and centre of the country is also viewed as key to this strategy. For this reason, it has been actively promoting foreign and domestic investment in these areas through the initiation of "rapid development zones." The entire Niassa Province, the Nacala District, Ilha de Moçambique, Ibo Island, and the Zambezi Valley qualify as zones. Rapid development Zones allow import duty exemption on certain goods and an exemption from the real property transfer tax.

It used to be a nightmare to start up a business in Mozambique. According to the World Bank, it used to take 153 days and involved 14 separate procedures. But these are figures from January 2004, and since then procedures have been radically simplified with the implementation of new licensing regulations. The regulations establish a maximum period of eight days for obtaining a local trading license, and traders are no longer restricted to specific geographical areas, but can move across the entire country without paying additional fees[76].

If these regulations are implemented, and extended to industrial licensing, then Mozambique will become comparable with Tanzania, where it takes 35 days to set up a company. While it is still a long way short of the simplest country in the world, Australia, where it takes just two days and two procedures to set up a business, it represents significant progress.

The government is also attempting to make labour regulations more flexible by streamlining procedures to hire expatriates, reducing retrenchment costs and facilitating temporary employment.

[76] According to the Minister of Industry and Trade, Antonio Fernando, a provincial licence should take no more than 15 days to issue, and a licence for a national company a maximum of 30 days.

7.3. Incentives and Impediments for/to FDI

7.3.1 FDI Promoting Regimes

(1) Investment Promotion Agencies

1) Investment Promotion Centre (CPI)

Mozambique's Investment Promotion Centre (CPI) based in Maputo is the primary vehicle used to attract foreign investment in the country and should be seen as a potential investor's primary entrée with the government. The CPI also takes a pro-active role in obtaining permits and approvals from different government ministries and national directorates on behalf of foreign investors. The Agency provides a 'matchmaking' service for foreign investors seeking to identify local Mozambican partners, and handles all projects related to non-mining sectors and where the equity to be invested is above US$5 000 for nationals or above US$50 000 for foreigners.

It is particularly interested in increasing investment in the centre and north of the country, to combat large regional differences in development.

A national investment promotion agency was started in 1984, but in its current form as CPI, has only been in existence since the new law on investments was passed in 1993. The three year plan of 1997 saw sweeping changes being implemented which ushered in a complete restructuring of CPI, towards creating a world class investment promotion agency. A number of new divisions were created, and this framework has allowed CPI to really come into its own over the past 3 to four years (although it still is in the process of re-structuring).

Until January this year it fell under the Ministry of Planning and Finance. After the ministry was split into two, the CPI now falls under the Minister of Planning and Development.

CPI offers a comprehensive service in support of foreign investors wishing to invest anywhere in the country. Some of the services provided by the CPI include:

- Information about the investment law;
- Registering investment project proposals;
- Assistance in registering new companies related to investment projects;
- Facilitating the approval of submitted projects;
- Identification of investment opportunities;
- Lending advice and support to investors;
- Incorporation of Company;
- Business Licensing;
- Facilitation of entrance visas;
- Facilitation of work and Residence Permits;
- Customs Authorizations;
- Identification and Licensing of Land; and
- Identification of Business Partners (Identificação de Parceiros para Negócios).

The CPI does little follow-up assistance and is rather more focused on compliance procedures being undertaken by the investor.

2) Application Processes and Systems

The investment approval process is cumbersome. The larger the investment amount the more government departments it has to go through for approval. CPI handles the process for foreign investments. The investment approval process is automatic within 10 days, if no objections are voiced by the relevant ministries; the provincial governor for investments under $100 000; or the Minister of Planning and Finance for investments between US$100 000 and US$100 million. The Council of Ministers (cabinet) must review investments over $100 million and those involving large tracts of land (5000 hectares for agriculture, 10 000 hectares for livestock or forestry projects). The Council has 17 working days to voice an objection before approval becomes automatic. The government has not used screening mechanisms to limit investment or protect domestic industry.

(2) Export Processing Zones

The government is anxious to see Industrial Free Zones (export processing zones) take hold and Decree no. 61/99 of September 21, 1999, supports this. These regulations established an Industrial Free Zone Council, (IFZC) which approves companies as industrial free zone enterprises thereby providing them customs and tax exemptions and benefits.

There are three essential requirements for investors to enjoy Industrial Free Zone status: job creation for Mozambican nationals, there must be a guaranteed investment of at least US$5 million, and the exportation of at least 85 percent of annual production. Industrial Free Zone developers enjoy an exemption from customs duties, VAT, and Specific Consumption Tax on the importation of construction materials, machinery, equipment, accessories, accompanying spare parts, and other goods destined for the establishment and operation of the Industrial Free Zone. The processing of cashew nuts, fish, and prawns are not acceptable industrial free zone activities. Free zone concessions are granted for a renewable period of 50 years. Mozambique’s big commercial success stories, such as MOZAL and SASOL, operate as industrial free zones.

The proposed new sites for the development of IFZs are at the Industria Ceramica de Mozambique site in Maputo province, Sofala province near the port of Beira, Nampula province and the port of Nacala. The Beira and Maputo free trade zones have already been officially approved.

(3) Incentives for FDI

Substantial fiscal incentives have been set aside for foreign investors, especially large investment projects. Investment projects involving the following economic activities shall be considered material to the promotion and acceleration of national economic development:

- Agriculture, including aquaculture, livestock and forestry;
- Agro-industry;
- Manufacturing;
- Construction of railway, road, port, and airport infrastructure related equipment; and
- Tourism activities.

<u>1) Tax Exemptions/Tax Holidays</u>

In November 1996, customs tariffs were revised across the board, reducing the average nominal rate from 18 to about 10 percent. The new tariff structure accomplished much to rationalize a chaotic system. To close collection loopholes, the number of discretionary customs exemptions has been drastically reduced.

An export industry located in an IFZ enjoys full exemption of customs duties, VAT, and import or export taxes on construction material, machinery and equipment. IFZ enterprises are also exempted from income tax.

The government also grants special fiscal, labour, and immigration arrangements for companies operating in a designated so-called “Rapid Development Zones”. Rapid Development Zones include Niassa Province, Nacala District, Ilha de Moçambique, Ibo Island, and the Zambezi Valley. Investments in these zones are exempt from import duties on certain goods, are exempt from the real property transfer tax, and are eligible for an investment tax credit equal to 20% of the total investment (with a right to carry forward for five years).

2) Subsidies

Tax deductions for investment spending on the professional training of Mozambican workers is allowed up to a maximum of 5 percent of taxable income, deducted from the taxable income for the first five years of a company's operations from the first day of commencement of activity. If the professional training is for the use of technologically advanced equipment, an amount of 10% is allowed to be deducted off taxable income.

(4) Impediments to Attract FDI

Mozambique is regarded as one of Africa's success stories in terms of reforming its laws and investment regimes to become very 'investor friendly'. Nevertheless, any investor looking in Mozambique must remember that the Mozambican business climate remains a work in progress. Excellent macro-economic policies and high-level commitment to attracting business mask a bureaucracy that remains at times unresponsive to the needs of corporations, especially small-to-medium-sized enterprises. The delivery of permits is slow although accelerating; corruption is problematic; and the legal system is antiquated. Customs is motivated by the need for enhanced revenue collection, and clearance procedures remain onerous.

7.3.2 Infrastructure

(1) Basics of Domestic Infrastructures

It is one of the main objectives for the Government that development, rehabilitation, modernization or expansion of economic infrastructures for operation of productive activities or rendering services.[77]Although the country is making an effort providing investment opportunities in infrastructure development, meeting infrastructure demands of investment remains a challenge. In a nutshell, transportation infrastructure remains inadequate for in-country shipments of goods and the movement of goods generally across the country. Export-oriented infrastructure is somewhat better, but still requires significant improvements. A number of programmes for rehabilitation has been implementing with substantial funding from the donor community[78].

Total roads account for 30,400km. Of which 5,685km are paved. The nation's internal road network is not well connected and in bad repair. The major north-south highway, while passable, degenerates as one moves away from the southern provinces. The lack of a bridge over the Zambeze River at Caia forces road transport to rely on a sporadically operating ferry or to detour through Malawi adding considerable time and expense to the journey. The nation's rail network of 3,123km in total is divided between northern, central, and southern lines without interconnectivity. Most lines are in good or at least reasonable condition but some others need rehabilitation to bring it back to operation[79]. The Sena line in the central remains closed[80]. Major sections of the Limpopo line in the south were severely damaged in 2000 flooding and are currently being rehabilitated[81]. Mozambique has three main harbours in Maputo, Beira, and Nacala that service the regional and domestic markets. Currently,

[77] The Government of Mozambique itself allocates 18.7% for infrastructure (mostly roads) from the budget of fiscal year 2005.

[78] For example, the United States Agency for International Development (USAID) has assisted to develop and rehabilitate important roads, bridges, and rail lines. Also, Sweden, Italy and the European Union financed for the bridge building programme.

[79] In the north, rail links between Nacala and Malawi are operational. In the central, one of two main lines, the Machipanda line is operational (for cargo traffic only) and in reasonably good condition. In the south, two of three main lines, The Ressano Garcia line and The Goba line are under operation.

[80] The line connects Beira to Tete via the planned Moatize coal mine and Zambezia provinces, with a spur into Malawi. Demining along the line was completed in March 2003, opening the way for rehabilitation.

[81] The line runs from Maputo to the Zimbabwean border and links Gaza and Maputo Provinces.

domestic shipping between the nation's three main and numerous minor ports is inefficient and costly. The country's main harbours are also in general disrepair, but efforts are being taken to upgrade key ports, with Maputo being the most noticeable area of improvement.

The supply of electricity is a high government priority, as only 7% of the Mozambican population enjoys access to electricity, and 80% of those who have access are located in urban areas. While electricity has become more reliable in Maputo with the de-mining of the main power line to allow better repair and maintenance, most businesses however have their own generators for use during power outages. In Maputo, these power outages are frequent and generally of short duration. The potential remains for hydro-power generation. Water resources itself are relatively rich with more than 60 rivers. Rivers and lakes occupy 13% of the surface land.

All fixed line telecommunications services remain the exclusive monopoly of State-owned Telecommunications of Mozambique (TDM). Although TDM lines cover all provincial and most district capitals and secondary towns, Mozambique's main telephone lines show a negative Compound Annual Growth Rate over the period 1998-2003, according to the International Telecommunication Union (ITU)[82]. While TDM has introduced digital switching through most of the network, the use of satellite relay for international calls results in increased costs and frequent network overloads and service interruptions. TDM has laid an offshore fiber optic cable to address domestic call problems, but problems with international call costs and network overloads remain and are likely to worsen if international traffic increases. Line maintenance by TDM is poor, and businesses whose lines go down often have to wait long periods to have service restored. Billing is problematic as well. Customers must carefully monitor charges to prevent overcharging. International calls on TDM are extremely expensive, and while there have been some reductions in international call prices by TDM, TDM remains more expensive than other operators (i.e., Telkom South Africa and Marconi -Portugal Telecom). Cellular services are provided by two companies. One is M-Cel with 500,000 subscribers, which is a subsidiary of TDM and the other is Vodacom from South Africa with 100,000 subscribers (but estimated to grow to 1 million by 2009). Cellular service is available in Maputo; along transport routes from Maputo to South Africa and Swaziland; and north of Maputo to numerous cities including all of the provincial capitals. Contrary to expectations from competition, domestic call prices have not decreased, but increased, for both fixed and mobile telephone services.

(2) Regional Programme

The so-called "development corridors" is a major strategy to attract investments in the country, which consist of rail and road networks into the interior of the country linking up with its neighbours. The three existent ones cover Maputo to the komatiport border with South Africa; Beira to Mutare (Zimbabwe); and Nacala to Mandimba (Malawi).

A fourth corridor known as the Mtwara Development Corridor[83], a joint development initiative of the governments of Malawi, Mozambique, Tanzania and Zambia, was launched in December 2004. The Corridor is aimed at unlocking the economic potential existing in parts of the participating countries through improved integration of infrastructure and investment in export oriented economic sectors. It was conceived in 1998 as a Spatial Development Initiative (SDI), which has become the building block of the New Partnership for Africa's Development (NEPAD).

In addition to the above, Mozambique is joining the plan for an undersea fibre optic cable which is set off the coast of East Africa[84].

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[82] There is discussion over this negative growth rate. It is attributed to the increase in mobile phone usage on one hand but also attributed to affordability constraints on the other.
[83] The project, which is envisioned to generate an initial investment in infrastructure worth US$2.6 billion with an annual production and exchange of goods and services pegged at US$2.4 billion, is touted to contribute massively to poverty reduction through creation of at least 250,000 jobs in the four countries.
[84] Refer to the section for Madagascar.

(3) Trend in Privatisation and Some Observations on Current PPPs

The government of Mozambique is trying to attract the private sector to the development of inland areas by granting management concessions and allowing the privatization of transportation networks. Preparations for privatization and/or sector liberalization of some parastatals have already begun. Only 11 large state-owned companies remain, including the national airline, telephone, electricity, insurance, oil and gas exploration, port and rail, airports, water supply, and fuel distribution companies. But there are visible progresses even in those areas. Five major cities has already completed the water system management contracts; Some ports including Maputo has contracted out to the private sector; and selling the state-owned telecommunications company and the national airline are on track.

Looking at the last major parastatals, it is said that a favoured privatization model is to incorporate the parastatal, granting the government 100% of the shares; the government then selects a strategic foreign investor to whom it sells 30% of its shares. The remainders of the shares are then sold to the strategic investor, employees, or to the public on the local stock market. The government has indicated it would like to find strategic investment partners for the national airline, Linhas Areas de Moçambique (LAM), the national telephone company (TDM), and the national electricity company (EDM), yet steps to move forward with privatization in these areas have been very slow. Another favoured model is to contract limited operating concessions with private firms. This is especially suitable for infrastructure sectors.

Generally speaking, Mozambique has successfully introduced Public-Private Partnerships scheme. The efficiencies of infrastructure services got improved. The US$70 million development of the Maputo Port is a case in point that progress is on schedule, and important improvements have already taken place in the harbour. However, there have been some concerns raised recently over the poor performance of railway line[85]. This implies the PPPs scheme is not necessarily a panacea for every case.

7.3.3 Currency and Monetary Systems

(1) General Conditions

Banco de Mozambique, the Central Bank, adopted a tight money policy in 2004 and was successful in easing strong inflationary pressure due to crop failure and appreciation of the South African Rand (in which Mozambique's import payments are mainly denominated). Thanks to falling inflation, interest rates were lowered. Prime rate stood at 18.5 % in October 2004.

The failure of two state banks which led to a banking crisis continues to have ominous implications for monetary policy. Money to be injected to the two banks is funded by issuance of government bonds. The government will restrict new borrowings to cut costs in 2005 – 2006.

According to EIU report, on the assumption that fiscal and monetary policies come along, the inflation rate is expected to decrease from 10.2% in 2005 to 8.5% in 2006. Good climate conditions to hold down food prices and stability of metical, Mozambique's national currency, to Rand and US dollar are also to be assumed.

The Metical appreciated against Rand and US dollar in the second half of 2004. Its appreciation against US dollar was expected to some extent, but the appreciation against the currency of South Africa, its major trading partner, was wholly unexpected. EIU predicts that the exchange rate of Metical to US dollar is expected as MT 22,472/US$ in 2005 and MT22,904/US$ in 2005 if US dollar develops hereafter stably against Euro or other currencies.

[85] Mozambican Transport Minister Antonio Mungwambe, for example, recently expressed his disappointment at the poor performance of the private consortium running the railway line from the northern port of Nacala to Malawi which had been leased out to the Nacala Corridor Development Company (SDCN), a consortium in which the major foreign partner is the Railroad Development Corporation (RDC) of the United States (US).

(2) Banking Sector

After 1992, the implementation the government's new economic reform programme saw foreign banks allowed to invest in Mozambique, interest rates deregulated, and the regulatory and commercial activities of the Central Bank separated. Banco de Moçambique assumed the Central Bank function while Banco Comercial de Moçambique (BCM) led the commercial banking sector.

Liberalization attracted many new entrants into the banking sector. Until 1992, the Banco Standard Totta de Moçambique (BSTM) was the only private bank operating in the country. Since then, it has been joined by the Banco de Fomento a Exterior (BFE) and the Banco Internacional de Moçambique (BIM), whose main shareholder is the Banco Comercial Português. The Banco Comercial de Investimentos (BCI) opened in mid-1997. Other international banking groups are also considering opening subsidiaries in Mozambique.

As recently as May this year, the government sold its minority 20 percent stake in Banco Austral, Mozambique's fourth-largest bank in asset terms. The bank has improved its performance substantially, according to 2004 results released in April. Assets had grown by 22%, deposits by 24% and profits by 60%, while its lending activity almost doubled. These results indicate that Banco Austral has made good progress in turning its operations around since the government sold 80% of its stake to South Africa's ABSA Bank in December 2001.

As the integrity of banking system was questioned, four major banks underwent a series of inspection. Banco Internacional de Mozambique (BIM), the biggest bank of Mozambique, was inspected by PricewaterCoopers, and was recognized to satisfy the regulations in terms of soundness, profitability, capital adequacy ratio, etc. due to consolidation of branches, dismissal of employees and modernization of internal control based on a restructuring plan of 2003. The inspection cost of BIM was borne by World Bank. The ongoing inspection of three other banks is supported by DFID, a UK development agency.

1) Restrictions on Financing

The several factors that affect financing on direct investment are the following:

- Direct investment in projects will be financed by own equity capital made available by the respective investors; and
- Financing made available through shareholder's loans and/or additional supplies of capital made available by the investors own resources, and for which remuneration shall not bear interest charges made on the undertaking in which they have been applied, shall also be considered as components of direct investment.

2) General Availability of Financing

Trade financing is readily available from Mozambican commercial banks. Medium-term project financing is more difficult and requires significant collateral. Long-term project financing is scarce. Venture capital in Mozambique is, at present, almost non-existent, although Grupo BIM may begin offering such in the near future.

IFC and the Commonwealth Development Corporation provide medium-term loans and equity finance in Mozambique from their South African offices.

The Southern African Enterprise Development Fund (SAEDF), a U.S.-government sponsored $100 million venture capital firm, serves medium-sized Mozambican entrepreneurs out of its Johannesburg offices. It has a correspondent relationship with BCI in Maputo.

3) Security of Guarantees (domestic and international)

Mozambique is a member of the MIGA, part of The World Bank Group. MIGA offers investment guarantees for private sector projects.

(3) Government Financing Schemes

Companies formed and registered with then participation of direct foreign investment are entitled to access domestic credit borrowing on the same terms and conditions applicable to local companies and in conformity with the relevant legislation in force in the country.

Project Financing: Mozambique received Millennium Challenge Account (MCA) eligibility in 2004 and will submit a compact (proposal) to the Millennium Challenge Corporation (MCC) listing several large-scale projects for which it seeks investment.

Mozambique is also a member of the MIGA, part of the World Bank Group.

Otherwise commercial banks in Mozambique are best suited for providing short-term loans, trade-related finance, and fee-based services. Medium-term loans are available, but demand stiff collateral requirements and are subject to high interest rates for the commercial sector. Long-term and mortgage-based lending is not generally available. Venture capital financing is almost unknown, although Grupo-BIM is beginning to explore this area. Leasing is an area of growing commercial bank interest. Many foreign companies find it advantageous to obtain offshore financing for their Mozambican operations. The range of services offered by domestic banks is limited, and innovation is not a hallmark of the sector.

(4) Foreign Exchange Controls

Although access to foreign exchange was greatly liberalized by the passage of a new Exchange Control Regulation Law, 3/96, promulgated on January 4, 1996, there are still some limitations on investors. Foreign investors are allowed to operate both local and foreign currency accounts, and foreign exchange retention accounts are permitted for 100 percent of foreign exchange earnings without formal justification. These may be used to purchase required imports.

Investment registration and repatriation application procedures must be followed to repay foreign loans, and for the repatriation of invested capital, profits, and dividends, in amounts greater than $5000. Different rules apply for different categories. For example, once all the necessary paper work has been completed applying for the remittance of funds abroad, foreign investors are entitled to transfer abroad up to the whole amount of the profits accrued to them in each financial year. However, the remittances of re-exportable capital or of the proceeds of any compensation derived from expropriation pay-outs be the state, shall be carried out in instalments timed over a period not exceeding five years and in such a way that the country's balance of payments are not substantially affected.

Recently, the foreign-exchange system has been going through some changes since the beginning of 2005. Previously, the central bank had been buying and selling foreign currency with commercial banks one at a time. However, an auction system was implemented in early January 2005, whereby the Bank of Mozambique is now simply selling its foreign currency to the highest bidder.

Availability of Forex: An application to purchase the necessary foreign currency must be approved by the Bank of Mozambique before an exporter or importer may purchase foreign currency from commercial banks or exchange houses. Such applications are routinely approved by the Bank upon presentation of documents relating to the goods in question within 15 days. Applications can be approved prior to the goods' arrival in Mozambique. Commercial banks and exchange houses may apply for authorization on behalf of their clients. Applications must include proof of the importer's/exporter's ability to finance the transaction. For advance payments in excess of US$50

000, a performance guarantee from a banking institution may be required.

7.3.4 Labor and Management

For the settled foreign companies in Mozambique, it is a serious and common challenge how to secure a qualified human resources, especially highly skilled labors[86] capable to be engaged in management or production/quality control. One reason for the shortage of a man of talent is attributed to the limited base in absolute amount of labors with high education. The increasing HIV/AIDS rates threaten to erode this base further. In addition, the recent high growth of country's economy leads to the high demand of such skilled laborers. Consequently, it is difficult to ensure the adequate quantity and quality of labors from the domestic market, and it becomes the task for private sector itself. Mozambican staffs are generally eager and willing to learn, but the shortage of trained and professional staff is covered by measures that premiums and fringe benefits are often be added to their normal salary.

It is possible to hire a foreign expatriate regardless of passed position, academic and professional qualifications whenever needed. But employing a local staffs is of course preferred as long as they are equivalent in ability. A work permit and identification card known as a “DIRE” is required for foreign expatriates at the moment of money transfer or other scene. It is time-consuming and frustrating to obtain the DIRE due to the nature of the bureaucratic process. The government does grant special fiscal, labor and immigration arrangements for companies operating in “Rapid Development Zones".[2]

Although under revision, the labor law is extremely pro-worker survived from the long socialism era, and remains an impediment to new foreign investment. The Constitution explicitly provides for the right to strike, with some exceptions for workers in public services and this right has been executed. However, the government is gradually learning that the current legislation is problematic for investors and employers in Mozambique and not compatible with private sector growth. With significant donor pressure to liberalize the law, the government is considering revising the law.[3] Once it will be taken in place, new legislation will become investment-friendly to some extent.

Wage levels vary from sector to sector.[4] For several years, the country's statutory minimum wage has increased slightly more than the inflation rate of the previous year. [5] It would become serious concern on the management side that it creates irrational rising costs of production. The Ministry of Labor is responsible for enforcing the minimum wage rates in the private sector and the Ministry of Planning and Finance in the public sector. While the minimum working age without restrictions is 18 years of age, the law permits the employment of juniors under some conditions. The standard legal work time is 40 hours per week, but it can be extended to 48 hours. After 48 hours, overtime must be paid at 50% more than the base hourly salary. Workers are entitled to 30 days of annual leave, except for the first year.

The labors have traditionally close ties to the government via trade unions. Also, relations between management and labor are generally stable. But in recent years, the government’s economic reform and liberalization programs and its sympathetic attitude towards large investors cause the growing concern among trade unions. The main points of concern are influence on minimum wages and job cuts. Although trade unions are becoming more vocal, they still do not have the financial and institutional capacity to be very effective. Out of estimated workforce of 9.2 million, only 200,000 or less than 2% of the workforce is unionized under the collective bargaining legislation.

HIV/AIDS infection rates in Mozambique are among the highest in the world. Official statistics show 12% of Mozambique's 17 million people are infected with the disease. HIV/AIDS is most prevalent

[86] Nationwide literacy levels are estimated at just 48% with municipal areas accounting for the majority of literate adults. Only 46% of enrolled males in primary school reach Grade V. The United Nations Development Programmes (UNDP) Human Development Index (HDI), which measures a country’s achievements in terms of life expectancy, educational attainment and adjusted real income, places Mozambique 170 out of 173 countries.

among young generation, particularly in urban areas and along the main transport routes linking neighboring countries. As a result of the expansion of HIV/AIDS epidemic, life expectancy will decrease from 50 to 37 years by 2010.[6] AIDS orphans in the country number anywhere between 300,000 and 370,000 and the United Nations Children's Fund estimates that number will top one million in the next 5 years.

With regard to HIV/AIDS in the workplace, *Mozambique Law No. 5/2002* of 5 February 2002 establishes general principles intended to prohibit discrimination in the workplace against persons who are carriers or suspicious of HIV/AIDS.

7.4. Official Development Assistance (ODA)

7.4.1 Overview of assistance by donors and international organizations

Since 1987, Mozambique has been working on structural adjustment programs supported by the IMF and the World Bank. In 2001, Action Plan for the Reduction of Absolute Poverty (PARPA), Mozambique's PRSP (2001-2005) was formalized. The overall aim is to reduce the number of people living in poverty to 60% of the total population by 2005 and 50% by 2010. It emphasizes six priority areas: 1) education; 2) health; 3) agriculture and rural development; 4) basic infrastructure; 5) good governance; and 6) macroeconomic and public financial management.

Donor coordination and harmonization are extremely active in Mozambique. Mozambique is highly dependent on aid and a large number of donors (23 bilateral and 23 multilateral) are active in the country. Thus, improving aid effectiveness is high on the agenda. At present, out of total ODA of approximately US$ 700 million annually, the program aid share can be estimated at only 35-40%[87]. Donors have been providing coordinated and untied support to the state budget since 2000. The formal basis for budget and balance of payment support operations is the Memorandum of Understanding (MoU), signed in 2004 between Mozambique, Belgium, Denmark, the European Commission, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Sweden, Switzerland, United Kingdom, and the World Bank ("G- 15"). In relation to this, sector wide approaches have already been adopted in health, education, agriculture and water sectors, and many of these sectors have already established the common funds.

The EC is one of the development partners supporting the Food Security Program with budget aid; providing technical assistance in the health sector and in public financial management; and pool funding in the education, health and transport/infrastructure sectors.

Table 7.9: Economic Cooperation towards Mozambique by Top 5 Donor and Japan

(US$ million)

	1998	1999	2000	2001	2002
1st	Italy 110.6	United States 70.6	United States 115.5	United Kingdom 185.2	Italy 446.5
2nd	Germany 85.2	Japan 63.3	United Kingdom 82.7	United States 91.8	France 431.6
3rd	United States 70.5	Portugal 52.7	Holland 61.6	Holland 86.6	United States 159.7
4th	Portugal 61.5	Germany 51.6	Germany 47.8	Denmark 48.3	Germany 156.9
5th	United Kingdom 53.0	Denmark 51.5	Denmark 46.9	Sweden 42.6	Japan 69.7
Japan	40.6	63.3	20.0	33.5	69.7
Total	712.7	593.2	623.5	720.2	1,661.0

Source: Compiled by MOFA Japan from OECD/DAC

87 Southern African Regional Poverty Network.

7.4.2 Assistance by donors and international organizations by country/organization

(1) Japan

In addition to food assistance and non-project grant aid, Japan is assisting in the priority areas specified in PARPA. Namely, Japan is assisting in education, healthcare, transport infrastructure, etc. Japan is also providing assistances to NGOs through the Trust Fund for Human Security. In addition, Japan provides technical assistances in the areas of education, healthcare, agriculture, forestry and fishing industries, agricultural development, public administration, human resources, media through accepting trainees and dispatching experts. In infrastructure, Japan has completed the highway bridge construction project that had been in operation since 2000.

Table 7.10: Recent ODA to Mozambique

(US$ million)

	Government Loan	Grant Aid	Technical Assistance	Total
2001	-0.75	26.66	7.61	33.52
2002	21.73	44.81	3.12	69.66
2003	-0.40	32.53	3.14	35.27
Cumulative Total	34.35	548.79	53.30	636.45

Source: Compiled by MOFA from OECD/DAC

(2) United States

The goal of USAID's 2004-2010 Country Strategic Plan for Mozambique is "broad-based, rapid economic growth sustained through expanded capacities and opportunities." The strategic framework consists of five strategic objectives: 1) sustaining rapid rural income growth in target areas; 2) increasing labor-intensive exports; 3) increasing use of child survival and reproductive health services in target areas; 4) reducing the transmission of HIV and mitigating the impact of AIDS epidemic; and 5) increasing democracy in municipal governance. USAID's strategic framework tracks closely with the Government of Mozambique's (GRM) poverty reduction and economic growth strategy, the PARPA.

Of these strategic objectives, USAID's priority is in sustaining rapid rural income, highlighting the over-arching importance of the agriculture sector to Mozambique's economic growth and poverty reduction goals. USAID aims to support the transition of Mozambique's smallholder sector to more commercial farming by increasing productivity and commodity sales, linking smallholders to a burgeoning agro-processing industry, and delivering direct assistance to critical points in the value-adding production chain. Mozambique's commercial trading networks will be strengthened by increased access to both markets and financial services. Of second importance is increasing labor-intensive exports, to support improvements to the enabling environment for private sector growth. It aims to exploit sector and firm-level opportunities for maintaining high levels of growth and reducing poverty through increased trade and investment.

In relation to trade and investment, USAID is providing technical assistance to the Confederation of Mozambican Business Associations (CTA) through a five-year grant to advocate for reforms that fortify the progress made to date towards more liberal trade and an improved business climate. In addition, USAID is providing long- and short-term technical assistance to the Ministry of Industry and Commerce (MIC) to conduct trade analysis and to formulate and implement better trade strategies.

(3) United Kingdom

Three areas of development are set out in DFID's Country Assistance Plan for Mozambique: 1) the creation of an enabling environment for sustainable and equitable growth, private sector engagement and attention to international trade and security issues; 2) the emergence of an effective civil society that supports public accountability and provides mechanisms for supporting citizen's rights and opportunities for participation; and 3) emergence of capable (responsive, transparent) government working together with civil society and private sector partners in ensuring an effective framework for sustainable pro-poor policies and service delivery.

DFID's aid contribution in Mozambique has increased from GB£47 million in 2004/2005 to GB£55 million for 2005/2006[88]. The bulk of these funds are channelled to the government's budget to support government's own development priorities. DFID is an active player among the Program Aid Partners, which is a group of donor agencies that provide this sort of budget support.

(4) World Bank[89]

The current portfolio comprises 18 active projects with a commitment value of about US$1 billion. In the Country Assistance Strategy (CAS) for Mozambique approved in 2003, the objectives are focused on the following three areas: 1) to strengthen governance; 2) to spur broad-based economic growth by improving the business environment; and 3) to improve the provision of services, particularly to the poor. This is the first CAS prepared by the World Bank as a joint effort of IDA, IFC and MIGA, which confirm the strong emphasis of the CAS on strengthening the investment climate.

Projects approved by the World Bank include a credit for the Beira Railways Project (US$110 million) in 2004, and the first Poverty Reduction Support Credit (PRSC) to Mozambique (US$60 million) in 2004, the Economic Management and Private Sector Adjustment Credit Project (US$120 million); Communication Sector Reform Project (US$14.9 million); Roads and Bridges Management and Maintenance Capacity Building Project (US$162 million); Mineral Resources Management Capacity Building (US$18 million). Projects in planning (pipeline projects) include the Trans-frontier Conservation Areas and Tourism Development Project; the Technical and Vocational Education Project; The Roads and Bridges Management Project II; the second Poverty Reduction Support Credit (PRSC II); The Legal Sector Capacity Building Project; the Financial Sector Technical Assistance Project; and the Urban Development Project.

As of February 2005, the IFC's committed portfolio totalled US$154 million. It consists of fourteen projects in agribusiness, the hotel industry, banking, and general manufacturing. Six of these projects are in the small-and medium-sized enterprise (SME) sector. IFC's main initiative in Mozambique has been the Mozal aluminium smelter. IFC support amounting to US$120 million for the first phase in 1997 was crucial for financing the US$1.3 billion project and was IFC's largest single investment globally at the time.

In 2004 IFC committed an US$18 million investment to finance part of the government's equity in the Pande/Temane Gas pipeline, along with IDA and MIGA support, and approved a US$3 million contribution to a US$12 million SME financing and technical assistance facility.

MIGA has a total outstanding portfolio of US$262 million in gross exposure, and US$192 million in net exposure consists of eighteen contracts of guarantee in the agribusiness, financial, infrastructure, manufacturing, oil and gas, and tourism sectors. Mozambique is MIGA's fourth largest client country and the largest in Africa. MIGA guarantees have facilitated an estimated US$2.8 billion of direct foreign investment in Mozambique. MIGA has nine projects in agribusiness, infrastructure, manufacturing, oil and gas, services and tourism. Clients include Mozal, Companhia de Sena (Marromeu sugar), Sasol (gas pipeline), Moma Mining (KfW), and Maputo port. MIGA also provides technical assistance to the Center for Investment Promotion (CPI).

[88] British High Commission
[89] World Bank Country Brief

8. SADC AND SACU

8.1 Policy Framework of SADC

8.1.1 Background and Institutional Framework of SADC

(1) Background

The Southern African Development Community (SADC) has been in existence since 1980, when it was formed as a loose alliance of nine majority-ruled States in Southern Africa known as the Southern African Development Coordination Conference (SADCC), with the main aim of coordinating development projects in order to lessen economic dependence on the then apartheid South Africa. The founding Member States were: Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

SADCC was formed in Lusaka, Zambia on 1 April 1980, following the adoption of the 'Lusaka Declaration - Southern Africa: Towards Economic Liberation'. The transformation of the organisation from a coordinating conference into a development community (SADC) took place on 17 August 1992 in Windhoek, Namibia when the Declaration and Treaty was signed at the Summit of Heads of State and Government thereby giving the organisation a legal character, transforming the "SADCC" from a coordination conference into SADC, the Community, and redefined the basis of cooperation among Member States from a loose association into a legally binding arrangement.

Accordingly, SADC opted for a development integration approach which recognizes the political and economic diversities of regional integrating countries including their diverse production structures, trade patterns, resource endowments, development priorities, institutional affiliations and resource allocation mechanisms. It addresses many of the production, infrastructure and efficiency barriers arising from the underdevelopment of the region. This approach also has the advantage of complementing trade liberalization with sustainable corrective measures, designed to cushion the least developed member countries against shocks arising from the removal of trade barriers. It further allows member states to define the scope and sectors of cooperation and to identify appropriate strategies and mechanisms to overcome impediments to integration and to address regional imbalances between member states.

The current Member States are Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe. SADC headquarters are in Gaborone, Botswana. Seychelles was a member, but withdrew last year since it felt SADC did little for its economic development and was an expensive exercise.

(2) Original Institutional Framework

This Treaty is a legally binding and all-encompassing documents by which countries of the region shall coordinate, harmonize and rationalize their policies and strategies for sustainable development in all areas for human endeavour.

The Treaty commits member sates to fundamental principles of:

- Sovereign equality of Member States;
- Solidarity, peace and security;
- Human rights, democracy and rule of law; and
- Equity, balance and mutual benefit

Member States are expected to demonstrate their commitment to act in accordance with these principles set out in Article 4 of the Treaty.

Decisions, policies and agreements entered into under the auspices of SADC are legally binding, and the Organization will have the necessary legal instruments to enforce such decisions, policies and/or agreements.

The Treaty provides for protocols which will set out the principles and procedures under which Member States will conduct their cooperation in specific areas.

Sanctions may also be imposed against member states, which:

- Persistently fail, without good reason, to fulfill obligations assumed under the Treaty;
- Implement policies which undermine the principles and objectives of SADC; and
- Are in arrears for more than one year in the payment of contributions to SADC for reasons other than those caused by natural calamity or exceptional circumstances that gravely affect their economies, and have not secured the dispensation of the Summit.

The sanctions shall be determined by the Summit on a case-by-case basis.

(3) Objectives

The objectives of SADC are to:

- Achieve development and economic growth, alleviate poverty, enhance the standard and quality of life of the peoples of Southern Africa and support the socially disadvantaged through regional integration;
- Evolve common political values, systems and institutions;
- Promote and defend peace and security;
- Promote self-sustaining development on the basis of collective self reliance, and the interdependence of member states;
- Achieve complementarily between national and regional strategies and programs;
- Promote and maximize productive employment and utilization of resources of the region;
- Achieve sustainable utilization of natural resources and effective protection of the environment;
- Strengthen and consolidate the long-standing historical, social and cultural affinities and links among the peoples of the region.

To achieve the objectives, SADC shall:

- Harmonize political and socio-economic policies and plans of member states;
- Mobilize the peoples of the region and their institutions to take initiatives to develop economic, social and cultural ties across the region, and to participate fully in the implementation of the program and projects of SADC;
- Create appropriate institutions and mechanisms for the mobilization of requisite resources for the implementation of programs and operations of SADC and its institutions;
- Develop policies aimed at the progressive elimination of obstacles to the free movement of capital and labour, goods and services, and of the peoples of the region generally among member states;
- Promote the development of human resources;
- Promote the development, transfer and mastery of technology;
- Improve economic management and performance through regional cooperation;
- Promote the co-ordination and harmonization of the international relations of member states;
- Secure international understanding, cooperation and support, and mobilize the inflow of public and private resources into the region;
- Develop such other activities as member states may decide in furtherance of the objectives of SADC.

(4) Restructuring of SADC Institutions

The SADC Heads of State and Government convened an Extra-Ordinary Summit on 9 March 2001, in Windhoek, Namibia, at which they approved a Report on the Restructuring of SADC Institutions, which spells out enhanced objectives and a Common Agenda for SADC based on the objectives as outlined in Article 5 of the 1992 SADC Treaty.

The Report on the Restructuring of SADC Institutions articulates a more explicit Common Agenda which takes into account a number of principles such as development orientation, subsidiary, market integration and development, facilitation and promotion of trade and investment, and variable geometry.

Based on the above principles, SADC's Common Agenda includes:

- The promotion of sustainable and equitable economic growth and socio-economic development that will ensure poverty alleviation with the ultimate objective of its eradication;
- The promotion of common political values, systems and other shared values which are transmitted through institutions which are democratic, legitimate and effective; and
- The consolidation and maintenance of democracy, peace and security.

In contrast to the country-based coordination of sectoral activities and programmes, SADC has now adopted a more centralised approach through which the 21 Coordinating Units have been grouped into four clusters, namely:

- Trade, Industry, Finance and Investment;
- Food, Agriculture and Natural Resources;
- Infrastructure and Services; and
- Social and Human Development and Special Programmes.

(5) New Institutions

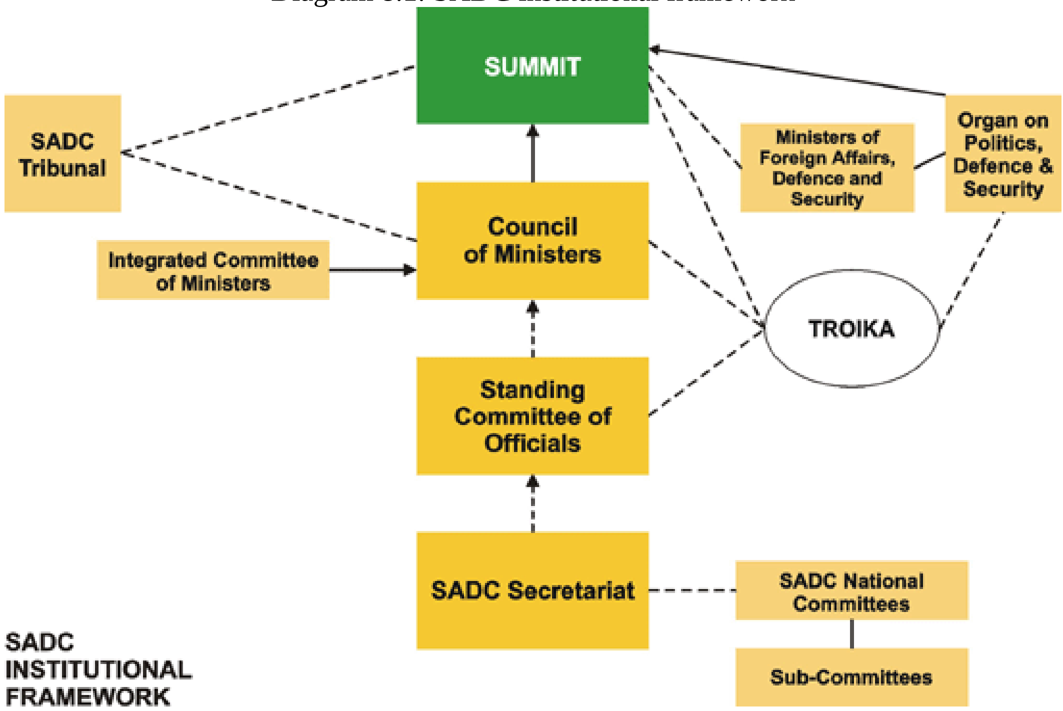
1) Integrated Committee of Ministers (ICM)

The ICM ensures policy guidance, coordination and harmonization of cross-sectoral activities. The ICM comprises at least two Ministers from each Member State.

2) SADC National Committees

These Committees have been established in each SADC Member State and their main function is to provide inputs at the national level in the formulation of regional policies, strategies, the SADC Programme of Action (SPA) as well as to coordinate and oversee the implementation of these programmes at the national level.

Diagram 8.1: SADC institutional framework



Source: SADC Secretariat

8.1.2 Policy Framework

(1) Regional Indicative Strategic Development Plan (RISDP) & NEPAD[90]

In order to provide strategic direction to the organization and to operationalize the SADC Common Agenda, a Regional Indicative Strategic Development Plan (RISDP) is in place. The RISDP is a 15-year plan to be implemented in phases of five years each. The purpose of the RISDP is to deepen regional integration in SADC. It provides SADC Member States with a consistent and comprehensive programme of long term economic and social policies. It also provides the Secretariat and other SADC institutions with a clear view of SADC's approved economic and social policies and priorities.

It reaffirms the commitment of SADC Member States to good political, economic and corporate governance entrenched in a culture of democracy, full participation by civil society, transparency and respect for the rule of law. In this context, the African Union's NEPAD Programme is embraced as a credible and relevant continental framework, and the RISDP as SADC's regional expression and vehicle for achieving the ideals contained therein. The RISDP emphasizes that good political, economic and corporate governance are prerequisites for sustainable socio-economic development, and that SADC's quest for poverty eradication and deeper levels of integration will not be realized if these are not in place.

The adoption of the RISDP by the SADC Summit of Heads of State brought renewed impetus to the SADC Protocol and Policy Implementation (PPI) framework. The RISDP constitutes a strategic framework for deeper regional economic integration and social development in the SADC region. In its scope and purpose, the RISDP provides strategic direction for the efficient implementation and delivery of the SADC Programme of Action over a period of 15 years. It aligns the overarching long-term integrated development goals and objectives with discrete policies and priority intervention areas, while enhancing and strengthening inter-sectoral linkages and synergies in order to accelerate poverty eradication in the region.

[90] "Regional Indicative Strategic Development Plan (RISDP)", SADC Secretariat, March 2003.

The RISDP implementation framework addresses such core issues as desired end-state quantified and scheduled targets, linkages, sequencing, prioritization criteria, speed of programme implementation and human and institutional competencies at the national and regional levels. Its short and medium to long run targets are to be met through the implementation - preferably by Public/Private Partnerships and other bodies undertaking SADC projects and programmes under the principle of subsidiary - of discrete projects and business plans regionwide, which are to be centrally managed by the SADC Directorates and Units.

The RISDP, unlike the Protocols, is an indicative, not a prescriptive policy instrument. It merely outlines the necessary conditions that should be realized towards achieving those goals. In order to facilitate monitoring and measurement of progress, it sets targets and timeframes for goals in the various fields of cooperation.

This, however, does not constitute, as some might fear, a source of conflict between regional policy objectives and programmes, or a relative weakness of the RISDP. The RISDP derives its core policy content from the existing Protocols and a concerted effort is being undertaken across the institution to align the SADC PPI framework with the RISDP in its role of steering the regional integration project towards a Common Market by 2015. As such, the effective implementation of the RISDP ultimately rests on the strength of the SADC legal framework and on the enforceability of the SADC Protocols.

(2) SADC Directorates' Business Plans

In a move to unbundle and operationalise the RISDP, SADC has developed business plans and budgets for 2005/2006 focusing mainly on the four directorates and two units. The business plans outline priority areas for the period 2005/6, which will be a stepping stone towards achieving the long term objectives of the 15-year strategic plan[91]. The SADC Council of Ministers approved the business plans, at their meeting in February in Mauritius.

<u>1) Directorate of Trade, Industry, Finance & Investment (TIFI) as Regional Economic Driver</u>

The overall goal of the Directorate of TIFI is to facilitate trade and economic liberalization and development for deeper regional integration and poverty eradication as well as the establishment of the SADC common market on a step-by-step basis.

The TIFI Directorate's Work Programme for 2004/2005 includes the following areas:

- Deepening market integration through the implementation of the SADC Protocol on Trade and facilitating negotiations for a customs union in the context of the multilateral trading system;
- Enhancing industrial competitiveness through the implementation of the regional industrial development policies and the SADC Protocol on Mining;
- Finalizing and commencing the implementation of the SADC Protocol on Finance and Investment for the achievement of macro-economic convergence, deepening of financial and capital markets and increased investments to support economic growth; and
- Promotion of investment and mobilization of development finance.

TIFI intervention areas 2005/6

- Goods and services market integration;
- Financial and capital market development;
- Attainment of deeper monetary cooperation;
- Attainment of macro-economic convergence;
- Increasing levels of intra-SADC Investment and Foreign Direct Investment (FDI); and

[91] *SADC Business Plans 2005/2006*, SADC Council of Ministers.

- Effective participation in compliance with international agreements.

2) Food, Agriculture & Natural Resources (FANR) Directorate

The directorate focuses mainly on five sectors -food security, crop development, livestock development, natural resource management and research and development. The food security challenges facing SADC require increasing productivity, eliminating food deficits and increasing trade in agricultural products.

FANR Intervention Areas 2005/6

- Ensuring food availability;
- Access to food;
- Improving food nutritional value and safety; and
- Disaster preparedness for food security.

3) Social and Human Development & Special Programmes (SHDSP) Directorate

Key sectors in this directorate are health systems, education, human resources development, culture and sport, information and employment. Its long-term goal is to coordinate all human resources development in the region.

SHDSP Intervention Areas 2005/6

- Developing and sustaining human capabilities;
- Developing positive cultural values, attitudes and practices;
- Increasing utilization of human capabilities; and
- Availability and access to information.

4) Infrastructure & Services (IS) Directorate

The primary function is to promote the provision of adequate, interconnected and efficient regional infrastructure. Key sectors are transport, communications and meteorology, energy, tourism and water.

5) IS Intervention Areas 2005/6

- Provision of adequate, integrated and efficient transport infrastructure and services;
- Provision of adequate, integrated and efficient communications and meteorology infrastructure services;
- Promotion of tourism as a means for sustainable development and regional integration;
- Facilitating the adoption and implementation of the strategic plan; and
- Integrated water resources management and related infrastructure development that contributes to regional integration and poverty eradication.

6) Statistics Unit Intervention Areas 2005/6

- Development of legal framework in statistics;
- Harmonization of statistics in the SADC region;
- Provision of relevant statistics for regional integration; and
- Statistical capacity development in SADC.

7) HIV and AIDS Unit Intervention Areas 2005/6

- Policy development and harmonization;

- Capacity building and mainstreaming HIV and AIDS into all SADC policies and programmes;
- Facilitating technical response, resource networks, collaboration and coordination; and
- Facilitating monitoring and evaluation of the regional multi-sectoral response.

8) Gender Unit Intervention Areas 2005/06

- Development of an explicit regional gender policy framework and harmonization of gender policies;
- Gender mainstreaming of SADC structures and institutions;
- Development and implementation at the regional level of women's empowerment in various sectoral areas;
- Communication, information sharing, coalition-building and networking;
- Training and capacity-building of national machineries personnel, national and regional trainers, decision-makers and other critical stakeholders on concepts, analysis, sensitization and empowerment skills;
- Monitoring and evaluation of the Beijing Platform for Action, SADC Declaration on Gender and Development and its addendum, CEDAW, the African Charter on Women.

8.2 Review and Evaluation of SADC-TIFI Programs

The SADC Secretariat conducted a review on SADC policies and programs as part of the review process to draw up the Regional Indicative Strategic Development Plan (RISDP)[92]. Among those, review on the current policies and programs on Trade, Industry, Investment and Finance are introduced in following.

8.2.1 Review of Current Policies and Strategies: Trade

The SADC Protocol on Trade, as amended, envisages the establishment of a Free Trade Area in the region by 2008 and its objectives are to further liberalize intra-regional trade in goods and services; ensure efficient production; contribute towards the improvement of the climate for domestic, cross-border and foreign investment; and enhance economic development, diversification and industrialization of the region. The specific strategies adopted to achieve these objectives are:

- The gradual elimination of tariffs;
- Adoption of common rules of origin;
- Harmonization of customs rules and procedures;
- Attainment of internationally acceptable standards, quality, accreditation and metrology;
- Harmonization of sanitary and phyto-sanitary measures;
- Elimination of non-tariff barriers; and
- Liberalization of trade in services.

(1) Evaluation of Trade Policies and Strategies

The overall objective of the SADC Trade Protocol is to attain a Free Trade Area as a step towards achieving a Customs Union and subsequently a Common Market. On the whole, the SADC trade policies and strategies are consistent with the objectives of eliminating obstacles to the free movement of capital, labour and goods and services and the improvement of the region’s economic management and performance through regional cooperation with the ultimate goal of eradicating poverty.

The success of this depends on the effective implementation of the trade protocol by all Member

[92] *SADC Trade, Industry and Investment Review 2003*; *SADC Trade, Industry and Investment Review 2005.*

States especially with regard to elimination of tariff and non-tariff barriers that takes into consideration the specificities of different Member States. These are to be accompanied by appropriate rules of origin, which will encourage the optimum utilization of regional resources and allow forward and backward linkages in the various production chains.

Measures have also been taken to harmonize customs rules and procedures. These coupled with internationally acceptable standards, quality, accreditation and metrology as well as harmonization of sanitary and phytosanitary measures are expected to enhance intra-SADC trade. As far as services are concerned, a legal framework will be adopted to ensure compliance with international commitments made by SADC Member States.

(2) Challenges for Trade Policies and Strategies

The key challenge for SADC is to establish a Common Market within a reasonable time frame in order to increase the percentage share of SADC trade in the world market. This will only be possible, when Member States comply with the decisions agreed within the framework of the SADC Trade Protocol and to speed up implementation bearing in mind the underlying principles and objectives of the protocol. This also entails compliance with and implementation of WTO obligations as well as taking advantage of preferences provided under the Cotonou Agreement and the Africa Growth Opportunity Act. It would be essential therefore to address the supply side constraints as well as competitiveness of industry with regard to production and to cushion the impact of the international tariff reduction on the development of the smaller, landlocked and less developed members of SADC.

As SADC moves into higher levels of integration such as the customs union, the issue of overlapping membership of SADC countries in a number of other regional bodies and the conflicting obligations arising thereof should be addressed urgently. A resolution on this issue would strengthen SADC's position as a building bloc of the African Union. The challenges posed by globalization especially within the framework of the WTO, the AGOA and the Cotonou Agreements should be taken into account. The other challenge is in developing new policies and strategies that would target vulnerable groups such as the rural and urban poor, small businesses, informal operators and women to ensure that they take advantage of the policies.

8.2.2 Review of Current Policies and Strategies: Industry

Current policies and strategies being pursued in the region focus on export promotion, promotion of industrial linkages, efficient import substitution, improvement of the investment climate, facilitation of imports of essential goods, regional human development, enhancing industrial support services, equitable distribution of industrial activity and adopting flexible market oriented exchange rates.

(1) Evaluation of Current Policies and Strategies

These policies are in line with the strategic objectives of harmonizing sound macroeconomic policies and maintaining a conducive environment for both local and foreign investment; development of deliberate policies for industrialization; and the development of economic and social infrastructure. SADC industrial policies and strategies have to a limited extent contributed to the development of industry in the region. There is need therefore to ensure a balanced and mutually beneficial industrialization in the region with focus on the promotion of industrial linkages and efficient utilization of regional resources for the creation of productive employment opportunities across the region.

(2) Challenges in Current Polices and Strategies

The industrial sector needs to withstand the challenges of globalization, which range from competitiveness to industrial and product diversification, productivity, technology transfer and research and development. This can only be achieved with an overall improvement in productivity and competitiveness combined with a diversified and balanced industrial growth in a wider, well-linked economic space that allows for the efficient and effective use of factors of production on the basis of increased value addition. The new industrial strategies and policies need to encourage the participation of women in the development of small and medium scale enterprises and promote the use of information and communications technology.

8.2.3 Review of Current Policies and Strategies: Mining

The main focus is on the development of a regional mining sector that is economically, socially and environmentally sustainable, capable of meeting the regional mining challenges as well as ensuring long-term competitive growth for the sector. To this end, policies are being harmonized with a view to improving investment climate, information flows and development of a commercially viable small-scale mining industry with greater participation of women.

(1) Evaluation of Current Strategies and Policies

The mining sector policies and strategies are in line with the SADC's strategic priority of promoting and maximizing productive employment and the utilization of resources of the region. Since the Protocol on mining came into force in 2000, mining legislation has almost been harmonized in all SADC Member States with the exception of the DR Congo. However, there is still need for harmonization of policies targeted at developing the sector. The sector has also achieved enhanced mineral prospectively and all Member States have accessible databases. Public and private mining and training institutions have been effectively networked. The sector is, however, still constrained in terms of dealing with barriers to the flow of factors of production in order to facilitate more investment in it. In an endeavour to improve export earnings and derive more benefit from minerals, SADC is developing strategies for value addition.

(2) Challenges in Current Policies and Strategies

The challenges in the mining sector include the acquisition of technology and know how to facilitate value addition, facilitating more investment in the sector and ensuring environmentally sustainable development. Another challenge is that of increasing the participation of small-scale operators and vulnerable groups including women.

8.2.4 Review of Current Policies and Strategies: Finance and Investment

The policy objectives for the finance and investment sector include encouraging movement towards regional macroeconomic stability and convergence through prudent fiscal and monetary policies, providing a framework for co-operation in the area of finance, promoting the development of sound investment policies and encouraging savings, facilitating and stimulating investment flows and technology transfer and innovation in the region.

The strategies for achieving these policy objectives for finance and investment include pursuit of macroeconomic convergence, co-ordination of direct and indirect taxes, liberalization of current and capital account transactions, reform of payments systems, resource mobilization through development finance institutions and other financial entities and improving incentives for investment. In addition, it is important that national investment acts, codes or guidelines facilitate investment in the region and that policies promote free movement of capital in SADC as well as encouraging Member States to accede to international conventions on the protection and guarantee of investments.

For a number of themes, Memoranda of Understanding (MOUs) have been prepared. The MOUs on Macroeconomic Convergence and Cooperation in Taxation and Related Matters have been signed while those on Investment promotion, Exchange Control Policies, Payment, Clearing and Settlement Systems, and Harmonization of Legal Operational Frameworks of Central Banks of SADC and Development Finance Institutions (DFI) are still being processed.

Other forms of cooperation exist amongst stock exchanges, commercial banks and non-banking financial institutions. Under the Macroeconomic Convergence MOU, Member States have agreed that to achieve and maintain macroeconomic stability, all countries should converge on stability-oriented economic policies, which include, restricting inflation to low and stable levels, maintaining prudent fiscal stance that eschews large fiscal deficits, and high debt servicing ratios, and minimize market distortions. A macroeconomic surveillance mechanism will be established to monitor the move towards convergence on selected indicators.

The MOU on Cooperation in Taxation and Related Matters underscores the need for cooperation on capacity building in the area of taxation with the aim of harmonizing tax regimes, the application and treatment of tax incentives, direct and indirect taxes and treaties to avoid double taxation.

(1) Evaluation of Current Policies and Strategies

The policies and strategies are generally consistent with the SADC Common Agenda and they conform to the overall strategic priorities of the region as they relate to achieving complementarily between national and regional strategies and programmes, creating appropriate institutions and mechanisms for mobilization of requisite resources and progressive elimination of obstacles to the free movement of capital.

There has been substantial liberalization of the banking, finance and capital markets as well as investment services in SADC unilaterally and through a number of agreements and memoranda of understanding. Apart from the ongoing initiative of developing the Finance and Investment Protocol, the sector has already implemented a number of activities to promote investment, such as the investment forums in the region and outside and the annual Southern African Economic Summit. The SADC Committee of Central Bank Governors has developed a monetary and financial statistical database, developed an information bank on the policies and structures of SADC Central Banks, improved the national clearance, payments and settlement systems and facilitated repatriation of bank notes and coin among SADC countries, among others.

Financial reforms in Southern Africa have largely focused on the banking sector with a view to making them more competitive. The main features of these reforms have been liberalization of entry into the banking industry, removal of official controls on deposit and lending interest rates, and strengthening of central bank regulatory and supervisory functions to improve prudence. The adoption of these financial reforms has permitted new financial institutions to enter the banking industry and facilitated the introduction of new financial products. These reforms have however not been sufficient to increase competition or stimulate increased savings mobilization and intermediation services in all countries.

Access to credit and capital remains an area of concern for small to medium enterprises and the vulnerable groups such as the disabled and women. Most SADC members are operating effective stock exchanges, which have an important role in mobilizing savings, facilitating privatization and attracting foreign capital.

However, except for the Multilateral Monetary Area (MMA) countries (Lesotho, Namibia, South Africa and Swaziland) there is no substantial integration in the monetary sector within SADC. As SADC approaches the Common Market, there will be need to coordinate and to some extent harmonize monetary policies in order to achieve balanced development of the region.

Seven SADC Member States have investment acts whose main aim is to attract foreign investment by offering low corporate and personal income tax rates; tax holidays and exemptions on profits, dividends, interest and royalties; exemptions from import duties and sales tax on inputs and capital equipment; tax rebates and drawbacks; and other allowances. In many respects these investment laws are similar and hence very competitive. Therefore, there is need for coordination of policies and activities for promoting investment in the region including acceptance by Member states to credit rating, which would give investors confidence in the region.

(2) Challenges in Current Policies and Strategies

The main challenge for SADC is to intensify the pace of integration and harmonization in this sector and to increase domestic savings and investment in the region. SADC also has to implement sound macroeconomic and prudent fiscal and monetary policies that will facilitate the reduction of inflation and interest rates, deficits, debts and the free flow of capital through liberalization of exchange controls. Another challenge is that despite substantial liberalization in the financial sector, small and medium enterprises continue to face difficulties in accessing credit from the banking system. There is also a need for financial reforms for the non-bank finance institutions. Such reforms should address the case for women entrepreneurs, who are constrained by laws and procedures, which deny them full capacity to access credit.

The other serious challenge facing the region is how to stamp out money laundering, which is assuming great proportions not only in the region, but also at the continental level.

8.3 Situation of SACU

8.3.1 Background and History

The Southern African Customs Union (SACU) is the oldest Customs Union in the world. It came into existence on 11 December 1969 with the signature of the Customs Union Agreement between South Africa, Botswana, Lesotho, Namibia and Swaziland. It entered into force on the 1st of March 1970, thereby replacing the Customs Union Agreement of 1910.

SACU meets annually to discuss matters related to the Agreement. There are also technical liaison committees which meet three times a year, namely:

- The Customs Technical Liaison Committee;
- The Trade and Industry Liaison Committee; and
- The Ad hoc Sub-Committee on Agriculture.

The aim of SACU is to maintain the free interchange of goods between member countries. It provides for a common external tariff and a common excise tariff to this common customs area. All customs and excise collected in the common customs area are paid into South Africa's national Revenue Fund. The Revenue is shared among members according to a revenue-sharing formula as described in the agreement. South Africa is the custodian of this pool. Only the BLNS (Botswana, Lesotho, Namibia, Swaziland) Member States' shares are calculated, with South Africa receiving the residual. SACU revenue constitutes a substantial share of the state revenue of the BLNS countries.

Following the formation of the Government of National Unity in South Africa in April 1994, Member States concurred that the present Agreement should be renegotiated in order to democratize SACU and address the current needs of the SACU Member States more effectively. With this in mind, the Ministers of Trade and Industry of the five member states met in Pretoria on 11 November 1994 to discuss the renegotiation of the 1969 agreement. The Ministers appointed a Customs Union Task Team (CUTT), which was mandated to make recommendations to the Ministers. CUTT has met on numerous occasions in the various Members States and good progress has been made in the renegotiation process.

8.3.2 The 2002 SACU Agreement

With the independence of Namibia in 1990 and the demise of apartheid in South Africa in 1994, SACU members embarked on new negotiations in November 1994, which culminated in a new SACU agreement in 2002. It addressed three outstanding issues.

(1) Joint decision making processes

Article 3 established an independent administrative secretariat to oversee SACU with its headquarters in Windhoek, Namibia. Article 7 created several independent institutions including a Council of Ministers, a Customs Union Commission, a Technical Liaison Committee, and a SACU Tariff Board to replace the South African Board of Trade and Tariffs. The SACU Tariff Board consists of five professionals from the five countries to oversee all changes to external tariffs. These institutions are designed to enhance equal participation by member states. The 2002 Agreement also provides for policy coordination in agriculture, industry, competition, and unfair trade practices, and protection of infant industries.[93]

(2) New Revenue Sharing Formula

South Africa will not receive its share of revenue as a residual, but will share on the same basis as the BLNS. Revenue allocations will be made after the budgeted cost of financing the SACU institutions. What remains will be allocated to the five member states in payments consisting of customs[94], excise[95], and development component[96].

(3) Question of external (outside SACU) trade

Since 1980, the Southern African Development Community (SADC) has offered alternative regional economic coordination to the BLS, to reduce their dependence on the South African economy, for the main challenge in all of Southern Africa involves the need to develop strategies that enhance the political, economic, social, and cultural integration of the region without jeopardizing the economies of the smaller states.

Since 1994, South Africa has negotiated a bilateral trade agreement with the EU, ignoring its SACU and SADC neighbors. SADC (14 members including all of SACU) has a schedule for staged liberalization of trade, allowing smaller economies and vulnerable sectors (e.g. food security) to be liberalized more slowly than the more powerful economies such as South Africa. In addition, unilateral negotiations by South Africa and the US seem to ignore all other regional coordination efforts.

At a meeting of Ministers of Trade and Finance Departments from the five SACU Member States, held in Centurion, Pretoria, on 5 September 2000, the Ministers reached consensus on the principles of underpinning the Institutional reform in the Southern African Customs Union.

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[93] Article 26: Protection of Infant Industries. 1. The Government of Botswana, Lesotho, Namibia or Swaziland may as a temporary measure levy additional duties on goods imported into its area to enable infant industries in its area to meet competition from other producers or manufacturers in the Common Customs. 2. Infant industry means an industry, which has been established in the area of a Member State for not more than eight years. 3. Protection afforded to an infant industry in terms of paragraph 1 shall be for a period of eight years unless otherwise determined by the Council. Article 26 is designed to protect the BLNS from being undercut by the South Africa's established industries.

[94] Each member's share of the customs component is the fraction of the member's value of goods imported from within SACU in a specific year divided by the total intra-SACU imports during that year. The custom component is likely to benefit the BLNS. In particular Lesotho and Swaziland rely of these revenues to finance government programs.

[95] Each member's share of the excise component is obtained after deductions for funding of SACU institutions and the development component have been made. The net amount is allocated on the basis of each country's GDP as a percentage of the total SACU GDP during that year.

[96] The development component is a fixed percentage of excise revenues, currently set at 15 percent. It is designed to benefit the smaller countries, as it will be distributed to all SACU members according to the inverse of each country's GDP/capita.

8.3.3 SACU Administrative Organization

The Administrative Institutional structure of the revenue pool that was discussed in 2000 was agreed to consist of the following:

- Council of Ministers: A body represented by one Minister from each SACU member state. It would be the supreme SACU decision-making body and would meet on quarterly basis. The decisions taken by this Council would only be by consensus.
- Commission: Administrative body comprised of Senior Officials, three Technical Liaison Committees and an established Agricultural Liaison Committee.
- Tribunal: An independent body of experts. It would report directly to the Council of Ministers. The tribunal would be responsible for tariff-setting and the Anti-dumping Mechanism.
- Secretariat: Responsible for day to day operations of the pool. It would also be funded from the revenue pool. Its location would be determined by Senior Officials who were directed to meet after a period of a month to develop proposals for the implementation of the revised SACU Institutional Structure.

SACU Ministers further agreed that the revenue share accruing to each Member State should be calculated from three basic components:

- a share of the customs pool;
- a share of the excise pool; and
- a share of a development component.

Further, it was agreed that these three different components would be distributed as follows:

- The customs component should be allocated according to each country's share of total intra-SACU trade, including re-exports;
- The excise component, net of the development component, should be allocated on the basis of GDP; and
- The development component should be fixed at 15 % of the total excise pool and distributed to all SACU members according to the inverse of each country's GDP/capita.

8.3.4 SACU Free Trade Agreement Talks with US

The United States and the five member countries of the SACU launched negotiations in mid-2003 toward a free trade agreement (FTA). This initiative represents another step in the growing trade and investment partnership between the US and southern Africa. When is eventually concluded it will be the first US FTA in sub-Saharan Africa and the first time the SACU nations have jointly negotiated such an agreement. The US administration has the objectives to drive global trade liberalization, to lower consumer costs, to create new commercial opportunities for U.S. companies, farmers and workers in fast growing regions of the world, and to draw developing countries into the mainstream of the global economy. The conclusion of an FTA with southern Africa is a vital part of this effort. Through an FTA, the United States would gain guaranteed preferential access to its largest export market in sub-Saharan Africa – worth more than US$2.5 billion in 2002. An FTA is also an opportunity to level the playing field in areas where US exporters were disadvantaged by the European Union's free trade agreement with South Africa and to create an environment that enables an expanded US trade and investment. Leading US sales to the region includes machinery, vehicles, aircraft, medical instruments, plastics, chemicals, cereals, pharmaceuticals and wood and paper products. U.S. foreign direct investment in the SACU countries totalled US$2.8 billion in 2000 [97].

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[5] Sources for this section: Business Day (Johannesburg) July 8, 2005, US Department of Trade; *"2004 Comprehensive Report on U.S. Trade and Investment Policy toward Sub-Saharan Africa and Implementation of the African Growth and Opportunity Act"* - Prepared by the Office of the United States Trade Representative - THE FOURTH OF EIGHT ANNUAL REPORTS, MAY 2004**,** *"The Proposed US-SACU Free Trade Agreement (FTA) - Comparison with the FTAA, CAFTA,*

For southern Africa, the US sees the FTA as an opportunity to build on the success of AGOA and to move the growing commercial ties between southern Africa and the US from one way preferences to full partnership. The SACU countries are leading AGOA beneficiaries, accounting for more than 70 % of US non-fuel imports under this program in 2001. South Africa is the largest supplier of non-fuel AGOA goods to the United States. Lesotho is top apparel exporter, and Botswana, Namibia, and Swaziland have seen their total exports to the U.S. increase by 40 to 75 % in 2002. The following are potential benefits that the negotiating parties mention as reasons for creating a FTA:

- Rationalization of SACU production and services into a viable regional economy;
- Further integration of SACU into the global economy;
- Increased attractiveness of SACU to investors by its gaining permanent market access to the largest economy in the world;
- Development through "trade not aid" for the BLNS (Botswana, Lesotho, Namibia, Swaziland); and
- Promotion of the growth of a largely untapped market for US investors.

The US and SACU have established a special co-operative group on trade capacity building specifically for these negotiations, with $2 million in initial funding from the US Agency for International Development (USAID). The co-operative group was established to meet regularly during the negotiations to identify needs and swiftly direct technical assistance resources to help SACU countries better prepare for and participate in negotiations, implement agreed commitments and take advantage of free trade.

The talks are divided into two phases.

- Phase One: Market Access issues (including trade in goods, customs procedures, rules of origin, standards, trade remedies, services); and
- Phase Two: "Second Generation" trade issues (including labour, environment, intellectual property, investment, and government procurement)

The negotiations began in Pretoria, South Africa in June 2003 and subsequent rounds were held in August 2003 (in Johannesburg), October 2003 (in Washington, DC), February 2004 (in Walvis Bay, Namibia), and May 2004 (in Maseru, Lesotho). After the initial optimism surrounding the FTA initiative and a deadline for reaching an agreement set for December 2004, talks stalled in mid-2004 for nearly a year. This was due to negotiators clashing on a range of issues. Two attempts to restart negotiations failed, until a meeting in Geneva in the beginning of July 2005 eventually set the scene to resume talks in September 2005. Officials at the talks stated that negotiations would resume in 'bite-size' fashion, with non-agricultural market access issues first on the schedule for the proposed September session. Apparently the two parties had also agreed to 'bank' agreements already reached, instead of reopening these to negotiation.

Because negotiations of the SACU FTA are still secret, not all the terms are known. It is understood that the five SACU countries have to align their policies on a number of 'new-generation' issues such as government procurement and intellectual property to effectively negotiate deals with the US on these issues. The US earlier blamed the talks stalling partly on capacity constraints within SACU.

US-Chile FTA, and US-Singapore FTA", July 2004: Jill Mary Verbeck, John Kemoli Sagala, Yin Min Kyi, Daniel Ogbaharya, Luke M. Olson. Political Science, Northern Arizona University, Flagstaff, AZ, *"Computational Analysis of the US FTA with the Southern African Customs Union (SACU)"* - July 6, 2004, Drusilla K. Brown (Tufts University), Kozo Kiyota (Yokohama National University and University of Michigan), Robert M. Stern (University of Michigan) RESEARCH SEMINAR IN INTERNATIONAL ECONOMICS, School of Public Policy, The University of Michigan, Discussion Paper No. 509

8.3.5 SACU-EU Economic Partnership Agreement (EPA)

Between South Africa and the EU, a free trade agreement (FTA) has already been concluded (ratified January 2000). Since July 2004 (talks first held in Windhoek), negotiations are underway to an EPA between the EU and the SADC. It aims to develop new regional trading arrangements compatible with the WTO rulebook by the end of 2007. Taking part along with the SADC Secretariat are Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland and Tanzania, with South Africa watching from the sidelines as an observer.

8.3.6 SACU and Mercosur

The Mercosur countries of South America (Brazil, Colombia, Argentina, Uruguay and Paraguay, with Chile and Bolivia associate members) represent a trade bloc that links all the Latin South American countries into an FTA of some 350 million people. Only English-speaking Guyana, Dutch-speaking Surinam, and French overseas territory Guiana are excluded, and it is hoped that Guyana and Surinam will join in due course (Guiana, legally part of France, is part of the EU).

Mercosur and SACU have been prominent in the effort to cement south-south trade relations which would reduce the dependence of developing countries on their wealthy northern neighbours. While the SACU/Mercosur agreements have progressed at a slower rate than the Mercosur/US and Mercosur/EU trade talks, part of the reason for this was the lack of significant trade volume between the two trade blocs. It is hoped that the conclusion of the Mercosur/SACU Trade Agreement will lead to increased market opportunities for the chemical, engineering, agro-processing, steel and transport industries.

In December 2004 the long-awaited Preferential Trade Agreement (PTA) between the SACU and the Mercosur bloc was signed. While the SACU-Mercosur agreement is a watered-down version of the full-blown free trade area initially envisaged, it provides a channel for preferential trade and a starting point for broader and deeper cooperation between the two regions. This PTA is, however, intended by both sides to be only a step on the way to the creation of a full free-trade agreement (FTA). A PTA covers trade in manufactured and processed products, while an FTA covers trade in all products and services.

Latin America, which is currently experiencing impressive annual economic growth of above 5% on the back of rising commodity prices, is enjoying a surge of foreign investment and improving business confidence. It is also a region where South Africa is forging closer political ties that are expected to deliver unique commercial opportunities for the future.

8.4 Official Development Assistance (ODA) to SADC region

8.4.1 Overview of assistance by donors and international organizations

Preliminary DAC figures indicate that net ODA from the principal donor countries rose by 4.8 % in real terms in 2004 to reach an all-time high of US$78.5 billion. This represents a fairly sharp nominal increase from US$52.4 billion in 2001, US$58.3 billion in 2002 and US$69 billion in 2003. Africa has benefited more than other continents from the upturn in aid flows. Africa's share of global ODA has risen from a low of 36 % of the total at the end of the 1990s to 46 % by 2003. This trend has been duly reflected in ODA flows to the SADC member countries, as shown below.

Table 8.1: Net Official Development Assistance (ODA) received by SADC member countries (2001-2003)

US$ millions	2001	2002	2003
Angola	**289**	**421**	**499**
Botswana	**29**	**38**	**30**
D.R. Congo	**263**	**1 169**	**5 381**
Lesotho	**56**	**76**	**79**
Madagascar	**374**	**373**	**539**
Malawi	**404**	**377**	**498**
Mauritius	**22**	**24**	**-15**
Mozambique	**933**	**2 054**	**1 033**
Namibia	**110**	**135**	**146**
South Africa	**428**	**505**	**625**
Swaziland	**29**	**22**	**27**
Tanzania	**1 271**	**1 233**	**1 669**
Zambia	**349**	**641**	**560**
Zimbabwe	**164**	**201**	**186**
Total	**4 721**	**7 269**	**11 257**

Source: compiled by ERA from World Bank, OECD data

However, much of the increase in aid to sub-Saharan Africa was driven by debt relief and emergency aid. Debt cancellation under the initiative for Highly Indebted Poor Countries (HIPC), initiated by the World Bank and the IMF in 1996, accounted for an estimated 19 % of ODA flows to this region in 2003-2004, according to the OECD. Emergency aid, including food aid, to countries facing natural disasters (drought, flooding etc), such as Malawi in the wake of the recent drought, armed conflict or post-conflict situations – such as Angola and the DRC – represented another 8 %. Although total ODA receipts by SADC countries more than doubled from US$4.3 billion in 2001 to US$10.7 billion in 2003 as shown in the table, this increase was largely due to a huge debt relief package – some US$4.5 billion – granted the DRC in an attempt to bolster the peace process and help Kinshasa kick-start its war-stricken economy. Mozambique and Tanzania, which are among the poorest member countries, are also major beneficiaries of HIPC debt relief. There are some fears that the increase in debt relief and emergency aid to African countries may in the end crowd out other forms of development aid, such as loans and grants for programs and projects. There are still several countries facing humanitarian crises or civic conflict (Sudan, Cote d'Ivoire, Togo etc) and they have not yet been able to take advantage of the HIPC initiative, now set to expire at the end of 2006.

Sub-Saharan Africa is the main target for ODA from the 17 of the DAC's 22 bilateral donors as well as the European Commission. The 15 EU countries that are members of the DAC, in particular France, are among the main bilateral donors to Africa in general, as well as to the SADC. The EU countries provide bilateral aid not only from their own national budgets, but also via the EDF (the European Development Fund), which is administered by the EC. The Commission also manages emergency and humanitarian aid via a special account in the joint EU budget financed by member countries' annual contributions. The EU and USAID are the two largest donors to SADC countries in the trade and investment, natural resource management, and agricultural sectors. France and USAID provide joint regional assistance in agricultural policy analysis. Sweden, the United Kingdom, Germany, USAID and the World Bank jointly offer regional technical assistance concerning management of water resources. Germany, Sweden, USAID and the African Development Bank promote regional trade and the development of transportation corridors in southern Africa.

8.4.2 Assistance by donors and international organizations by country/organization

(1) European Commission

In recent years, the European Commission has implemented a new strategy for assistance to private sector development. The new strategy, which has been developed for the benefit of the African, Caribbean and Pacific (ACP) group of countries associated with the EU under the 20-year Cotonou Agreement covers five priority areas and involves technical as well as financial assistance of a significant magnitude over periods of five to seven years. The five priority areas are: 1) Macro-economic and business environment; 2) Investment promotion and partnerships; 3) Investment financing and financial markets strengthening; 4) Promotion of services for the development of Small and Medium Enterprises (SMEs); and 5) Development of Micro Enterprises.

The European Commission has introduced a new, €20 million instrument known as the Private Sector Enabling Environment Facility (PSEEF) to boost aid for the improvement of the business environment in ACP countries, including the SADC. The PSEEF will also support analysis of key issues in private sector development, including technical assistance accompanied by macro-economic support to improve public and private sector governance. The PSEEF will support the EU's European Investment Bank (EIB) in the implementation of its Investment Facility for ACP countries, and carry out studies in such fields as public enterprise reform, privatizations and public-private partnership operations.

The EU's €110 million PRO€INVEST program, covering a seven-year period, became operational in the second half of 2002. It aims at promoting investment and partnership agreements in the ACP countries with the emphasis on regional and sectoral approaches. It is being run by a special management unit in the EU's Centre for Enterprise Development (CED) under the supervision of EuropeAid, the European Commission's development aid wing. In the Southern African region, Pro-invest is cooperating closely with the CED in the implementation of ESIP, a five-year EU-SADC investment promotion program for which a total amount of €18.3 million has been set aside. The ESIP program has suffered significant delays, essentially because of the sweeping reorganization of the SADC secretariat, which chairs the ESIP management committee.

The EU's €2.4 billion Investment Facility, set up under the Cotonou Agreement and managed by the European Investment Bank (EIB), is one of the EU's main instruments for EU support for private sector development. The Facility, which includes €200 million for interest subsidies, provides loans, but also operates through equity participations in targeted companies, or by offering financial guarantees for fund-raising in the markets. Its actions are also designed to reinforce the capacity of intermediaries and the local financial markets. The Investment Facility became operational with the entry into effect of the Cotonou Agreement in 2003.

At the regional level, the EU had, as of April 2005, made available an overall envelope of €171 million of trade-related support to the SADC. This includes a €7.5 million SADC-EPA negotiations support facility, support of just over €1 million for the SADC regional integration and multilateral trading system, and the €18.3 million ESIP programme, as stated above.

The Brussels-based Centre for Enterprise Development (CDE) which provides technical and other assistance for private sector development, formally inaugurated its regional office for Southern Africa in Gaborone, Botswana, during the SADC ministerial meeting in August 2005. The office has been operating since January 2005 in the building of the Botswana Export Development Authority (Bedia) as part of the CDE's policy of decentralizing its operational activities in order to increase its impact in the field.

(2) United Kingdom

In recent years, the UK has been one of the strongest advocates of increased assistance to Africa. This was clearly demonstrated by the Prime Minister Tony Blair, when he put development of Africa as one of the primary topics for the G8 Summit in which he held the chair at Gleneagles this year. The Blair Commission for Africa, which is a comprehensive study of Africa with recommendations including doubling aid levels over the next three to five years and 100% debt relief for poor Sub-Saharan countries, came out timely before this Summit and the MDGs mid-review. In the report, there is also a suggestion of a new pooled fund mechanism, the Investment Climate Facility (Facility) where donors and private sectors will pool a large fund of around US$50 million, to be used to improve the investment climate in Africa.

In addition to the bilateral aid to each country, DFID spends an additional GB£7 million (R105 million) per year for the regional work in SADC. The UK also provides approximately £30 million (R450 million) per year to the region through the EU and other international development agencies. DFID Southern Africa is responsible for DFID's work in Botswana, Lesotho, Namibia, South Africa and Swaziland and also work with other DFID country offices in the Southern African Development Community (SADC) to support programs addressing the regional dimensions of poverty.

DFID works with SADC countries to make trade easier, fairer and pro-poor, by helping to strengthen trade policy analysis and trade negotiating skills in the region, for example, around trade agreements with the EU and negotiations with the WTO. DFID supports the development of a regional trade programs to increase trade within SADC and to expand the region's exports to the rest of the world.

In addition, across the region, DFID is supporting land reform process to offer more economic opportunities to the poor people. For example in South Africa, DFID is providing support for the consultation process on the Communal Land Rights Bill. In Lesotho, DFID is helping to develop the White Paper on land reform and the legislation required to make it work. At the more grass root level, FinMark Trust funded by DFID promotes increased access to financial markets by those who either have no entry point to banking and financial services or have no ability to make use of these services. DFID is also supporting the design and development of a SADC land reform facility.

(3) United States

The Initiative for Southern Africa is USAID's regional development program covering southern Africa. It is managed from the agency's Regional Center for Southern Africa in Gaborone, Botswana, and is distinct from USAID's bilateral country programs in the region. The Initiative for Southern Africa includes activities that address: 1) the establishment and strengthening of democratic practices and norms; 2) the expansion of trade and investment; 3) the improvement in management of shared wildlife and natural resources; and 4) agricultural development through technological changes in farming practices and increased trade in farm products. These objectives build the capacity of regional institutions; harmonize policies in the trade, customs, agriculture, environment and democracy sectors; increase the participation of the private sector in development; and generate employment and income growth.

A major component of the Africa Bureau's economic growth program is the Trade for African Development and Enterprise (TRADE) initiative, which was created to help African economies increase import and export opportunities and become better integrated into world markets. To support the TRADE initiative, USAID has opened three regional Hubs for Global Competitiveness—located in Botswana, as the Southern Africa Trade Hub—to provide technical assistance to African governments, the private sector, and regional organizations. TRADE Hub programs are designed to reinforce regional and bilateral efforts to strengthen Africa's economic competitiveness and assist the nations of the area to take greater advantage of the trade opportunities provided by the African Growth and Opportunity Act (AGOA) and other global trade initiatives. Hub program themes include trade capacity building, improvements to the private sector enabling environment, better market access and opportunities, trade facilitation, lower business costs, food safety programs, and export promotion of higher quality, profitable African agricultural produce. The Hubs will also provide support to the Initiative to End Hunger in Africa (IEHA).

8.4.2 Aid projects through SADC Secretariat

To our knowledge, there is no ongoing aid project by major donors that can be described as region-wide, that are channeled through the SADC secretariat. There is a so-called "administrative deficiency" in the secretariat and thus, aid agencies tend to avoid working directly with the SADC secretariat. The secretariat has been undergoing sweeping reforms over the past three years, however, criticisms remain that there had been little real change and some departments are still not operational, partly because the appointment of officers has been much delayed in many cases[98].

As its first SADC project, in 1999 Japan has built the Chirundi Bridge on the border of Zambia and Zimbabwe (¥1.5 billion grant-aid project). Japan also gives a small grant to support the SADC Secretariat[99] to support holding workshops or to be funneled to the SADC agriculture centre. In addition, an expert has been dispatched to the secretariat since 1996. However, like most donors, Japan prefers to assist the SADC countries bilaterally.

[98] Based on interview with donors by the ERA.
[99] In 1995 and 1996, the assistance amounted to 200,000 USD per year, but this has been further cut down.

9. PROPOSAL – JAPANESE COOPERATION TOWARDS REVITALISATION OF THE PRIVATE SECTOR

9.1 Direction of aid

9.1.1 Issues regarding technical assistances for African development

African economies, including that of South Africa, had been in stagnation for a long time since the second half of the 1970s and their GDP per person had been eroding. When a country's purchasing power is declining due to prolonged slow economic growth, it is difficult to stimulate corporate activities unless corporations can find markets outside of their country. In Africa, where a high-cost structure has been firmly put into place[100], interventions at the firm level cannot acquire comparative advantage or international competitiveness, thus export promotion is also problematic. Productivity stagnated both in manufacturing sector and in agricultural sector. Therefore, until recently, Africa was only able to achieve a rate of economic growth that was below the rate of population growth.

On the other hand, micro enterprises and informal sectors that account for a considerable proportion of the African economies are thought to have dynamic growth potential. However, because these sectors rely on the fringes of the domestic market, they cannot expect growth without an active national economy. However, with a stagnant domestic economy as discusses above, the prospects of the markets to spread and to achieve profits are very little. Therefore, it is important to note that even for low income countries, the economies of the African countries are deprived of many of the favorable conditions for development and are thus intrinsically structured disadvantageously to small enterprises.

Technical assistance projects that have been implemented under the abovementioned conditions are thought to have the following problems. First, improvements in the technical levels of firms without solving the problems of small domestic demand and linkages to markets are not likely to achieve the growth of private sector and the proceeding economic development. For this reason, promoting industry in Africa is far more different from promoting industry in Asia that is blessed with rich domestic markets, including industrial demand.

Moreover, technical assistances in the past have not fully addressed the intended improvements of technical levels by enterprises. In other words, government organisations, who were the direct benefices of cooperation and who are anticipated to train the enterprises, have failed to understand the private sector and to carry out influence, and have not been able to realize their full potential due to human resource capacity and budget constraints. These problems can be understood as problems of governance and capacities for the aid recipient countries rather than the failure of technical assistance per se. However, as long as technical assistances are to be used as development assistance between governments, one must take into consideration these constraints when searching for a configuration of effective technical assistance.

Therefore, one must recognize that conventional methods are inadequate in order to enhance the performance of enterprises to achieve the major objective of “revitalizing private sectors” in Africa. One cannot expect positive effects unless we add something extra "alphas" to aid components, such as human resources development, technological guidance, financial assistance and development of

[100] Along these lines, Africa's low-productivity agriculture lies at the root of its high-cost structure and Africa's low food productivity is the primary cause for its high prices and wage standards as compared with those in developing Asian countries (Hirano [2005]). The slow progress in poverty reduction is due to the fact that about 50% of Africa's total labor force is engaged in low-productivity grain production and that 80% of the poorest segment of the population is concentrated in this sector. The history of economic development shows that overall increase in income through promotion of private-sector industries and industrial development cannot be achieved without improvement of the productivity in food producing agriculture (Hirano [2003]). Therefore, industrial development, including promotion of FDI and fostering of enterprises, and agriculture development must be consistently incorporated in development policies.

institutions.

The "plus alphas" are commodity demand and markets. This is because enterprises can earn profits only from markets. Analyzing and recognizing local situations accurately can only obtain the judgment as to what commodity demand will actually be. For local African enterprises, accessible potential markets are beyond their national borders and the inflow of FDI backed by globalization has been offering totally different business opportunities than before to the private sectors of African countries.

9.1.2 Dramatic changes of the African economy

The African economy, which had been stagnant for more than 20 years, has undergone dramatic changes in recent years. The changes were triggered by South Africa's entry into the international community after achieving democratization in 1994 and a surge in resources prices centering on oil in the 21st century.

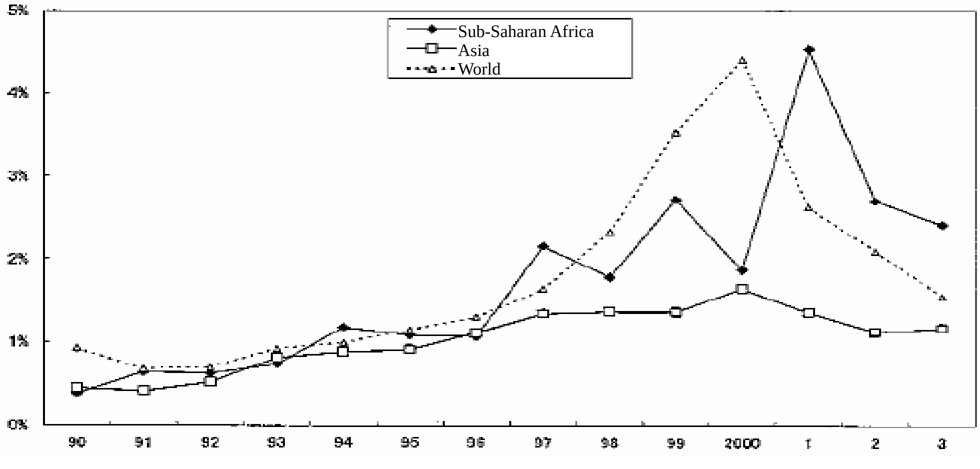
The entry of South Africa, which is by far the largest regional power in Africa, has altered the shape of the African economy (Hirano [2002: pp.130-134]). Moreover, the African economy has been undergoing transformation not spontaneously but triggered by world economic trends, riding on the crest of global movement to develop mining in quest of new resource supply bases. However, these bedrock facts are not well recognized in Japan.

(1) Inflow of FDI

It is often said that "inflow of FDI into Africa is small." This is not correct. We cannot mention Japan and African countries in the same light. When making comparisons, we have to standardize economic quantity. It's only natural that "the absolute amount of inflow and accumulated asset of FDI in Africa is small" as compared with Asia that is far bigger than Africa in terms of gross product, size of population, scale of investment, and historical records of FDI acceptance. In order to evaluate actual situations, it is necessary to see FDI inflow relative to economic scale.

Figure 9.1 shows the ratio of FDI inflow to total regional GDP. The figures for Africa on the whole are comparable to those for Asia and in recent years, the inflow ratio for Africa has been higher than that for Asia. The figure shows that Africa has received FDI commensurate with its economic size.

Figure 9.1: Ratio of FDI to GDP



Source: UNCTAD FDI Database; UN Statistics Division Database.

Table 9.1 shows the ratio of FDI inflow to total fixed capital formation in African and Asian countries. The figures for newly developing oil-producing countries in Africa are extremely high, indicating these countries are enjoying high economic growth backed by an inflow of huge amounts of capital.

But they are also the countries with serious problems in terms of governance and social indicators[101]. This is in stark contrast to Singapore that has been accepting huge amounts of FDI on the basement of its open market system. This accounts for the fact that the inflow of FDI into Africa does not lead to overall development of economy and society, unlike in the case of Singapore. While Singapore and other newly industrializing economies in Asia are accepting FDI by using their national power based on their domestic labour force as inducement to FDI, the amount of FDI inflows into such countries as Equatorial Guinea, Chad, Sudan, Mauritania, and Angola is determined by the quality and quantity of the resources they happen to have within their own territories. Therefore, the fruit of economic growth through FDI is unevenly distributed to people in the high income bracket and does not benefit the society as a whole, leading to little progress in poverty reduction.

It can be said that after the turn of the century, more FDI is flowing into some African countries than the countries' can digest in a consistent manner, or more than their real strength.

Table 9.1: Ratio of FDI Inflow to Gross Fixed Capital Formation (2003)

	%		%
Equatorial Guinea	295.9	Vietnam	15.2
Chad	127.9	Malawi	12.4
Sudan	80.1	China	12.4
Mauritania	79.5	Namibia	12.3
Singapore	45.7	Malaysia	10.8
Mongol	44.2	Lesotho	9.6
Angola	43.9	Botswana	6.9
Hong Kong	38.4	Mauritius	5.5
Nigeria	36	Madagascar	5.3
Corte d'Ivoire	34.2	Kenya	5.2
Mozambique	29.9	Thailand	5.2
DRC	23.6	South Africa	3
Swaziland	18.2	Zimbabwe	2.5
Zambia	16.2	Indonesia	-1.8
Tanzania	15.6	World average	7.5
Pakistan	15.4	Developing country average	10

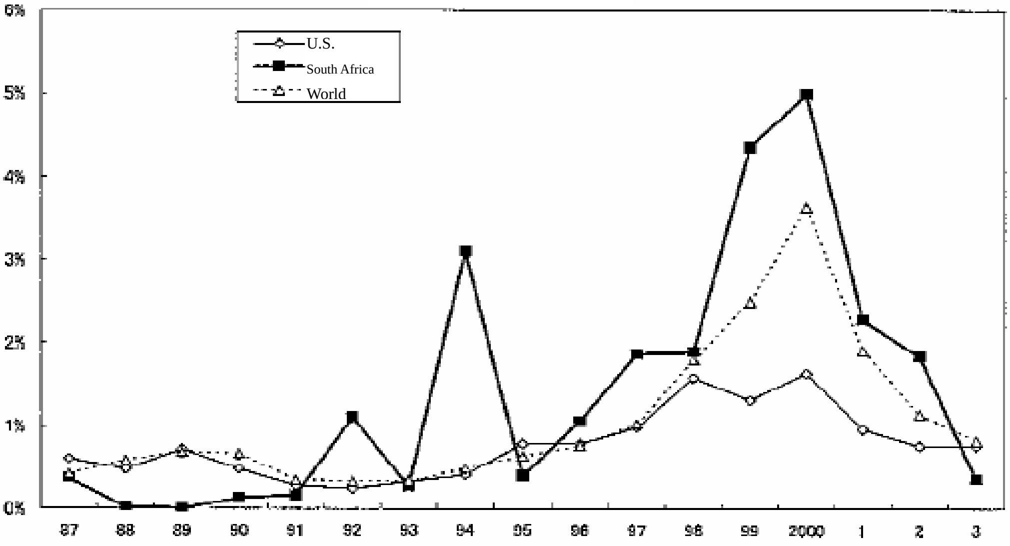
Source: UNCTAD FDI Database

(2) FDIs in Sectors Other Than Mineral Resources

At present, many of the FDI in Africa are for the purpose of oil-well drilling, followed by exploration of iron ore, coal, and other mineral resources in that order. However, South African capital shows a unique movement.

101 Human Development Index (HDI) rankings in the world are Equatorial Guinea=109th, Sudan=139th, Mauritania=152nd, Angola=166th, and Chad=167th (UNDP, 2004). According to the World Bank, "Rule of Law" indicators in 2004 were Equatorial Guinea -1.05, Mauritania -0.62, Sudan -1.59, Angola – 1.33 and Chad -1.15. indicators for the strength of corruption control were Equatorial Guinea -1.65, Mauritania +0.02, Sudan -1.30, Angola – 1.12 and Chad -1.14 (highest=+2.5, lowest=-2.5; WBI). Currently, these countries with serious governance issues are the top recipients for FDI within Africa. Therefore, the general understanding that "good governance are the key to inviting FDI, and vice versa", does not hold true.

Figure 9.2: M&As by South African Capital



Source: UNCTAD FDI Database; UN Statistics Division Database

Figure 9.2 shows the ratio of M&A, the largest mode of FDI, to GDP in South Africa, U.S., and the world. Worldwide, the ratios have been on a declining trend after hitting a peak at around the turn of the century. Still, the figure shows that FDIs by South African enterprises have been very active. South Africa's ratio of FDI outflow to its economic scale is far larger than comparable ratios for BRICs and Japan. South Africa is similar to developed countries in that it is an investing country.

As in the case of advanced countries, South Africa's FDI takes the form of purchases of foreign assets by non-banking sectors. About 70% of the FDIs have been accumulated in Europe, mainly Britain. Of the foreign assets, 4.7% were purchased in Africa, with the stock standing at US$4.2 billion as of 2003[102] (SARB [2005]).

Amid the oil development boom in Africa, investment by South African enterprises in Africa is noteworthy in that they have been actively investing in sectors other than oil exploitation. Of course, South African mining companies have been operating in various countries[103]. But many other companies have been engaged in a wide–range of industries, including tourism, retail, banking, mobile phone, beer production and distribution, construction, etc. Among the public corporations that have been operating abroad are Eskom (electric utility supplier), Spoonet (railway), and South African Airways. Industrial Development Corporation (IDC) and Development Bank of Southern Africa (DBSA) extend loans for these private and public activities in Africa.

Since the 1990s, South Africa has been making up for its trade deficits with developed countries and its trade surpluses with other African countries (Hirano [2002: p.130]). In recent years, South African corporations have been promoting businesses in the U.S., Europe, and Australia, but are fighting an uphill battle due partly to late entry into the markets after the democratization of their country. Therefore, Africa is a very important market for South Africa. If the economies of African countries grow, it will bring benefits to South Africa. In fact, South African corporations are generally enjoying high profitability from their investment in Africa. They are a group of corporations most well versed in African business. It is amazing that South African corporations have been earning profits in the

[102] South Africa's investment destinations are mostly SADC countries, with the largest portion going to Mauritius, followed by Mozambique, Zimbabwe, Namibia, and Swaziland in that order.

[103] AngloGold Ashante, which has been operating in Tanzania and Ghana, is a gold mining company under the wing of Anglo American Corporation (AAC). AAC has moved its headquarters to Britain. BHP Billiton, the world's largest mining house that has been operating a highly profitable aluminium refining plant (Mozal) in Mozambique, is based in Britain and Australia. It came into being as a result of the merger of Gencor, a South African enterprise that has established Mozal, with BHP and Billiton.

livelihood sector of low-income countries with per-capita income of less than US$500. Chinese and Indian corporations are also highly motivated to make inroads into non-mining businesses in Africa. However, South African corporations' dominance in African business will be little affected[104].

One must keep in mind that South Africa is the effective creator of the New Partnership for Africa's Development (NEPAD) and that the country is extremely keen in assisting Africa, because South Africa believes that economic growth of Africa is in the interest of the country. Without such a perspective, one will lose sight of the direction of NEPAD[105].

9.1.3 What are the directions of aid policies based on new situations?

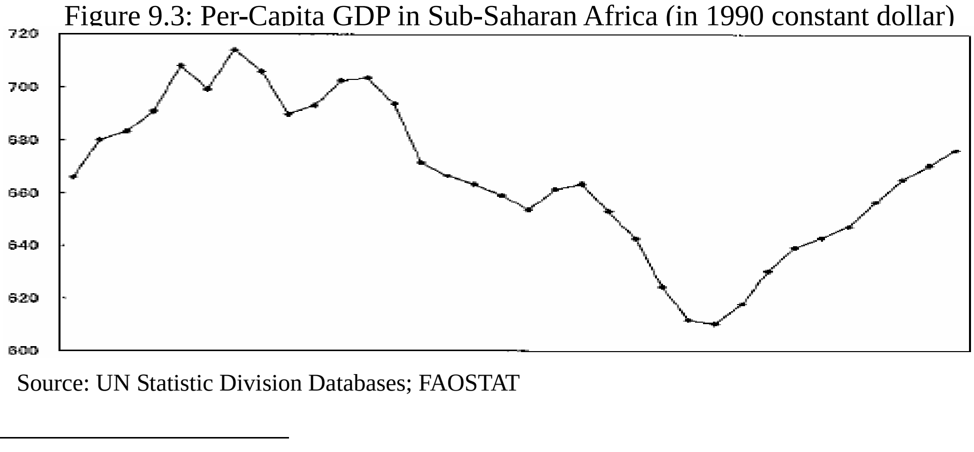
The African economy has undergone changes. Africa is no longer marginalized in the world economy. It has been incorporated in the world economy as an oil-producing continent and as a mineral resources supplier. It is also being reorganized as the habitat of the ever-expanding South African economic bloc. As Figure 9.3 shows, the African economy, which was once seen as hopeless, appears to have improved its performance dramatically.

The problem is that improvement in the economic growth rate through economic restructuring has not led to poverty reduction. Rather, it appears that the income disparity has been widening. It is not unusual that income disparity widens in the initial stages of economic growth. But present Africa totally lacks the dynamics that would reduce poverty by using the country's economic growth. The unemployment rate has remained at a high level, the rural population has been increasing while agriculture income has remained flat, the average life expectancy has kept decreasing, and there is no conspicuous improvement in the school enrolment rate.

On the other hand, when looking at the international trends in African development, it is evident that a clear measure to tackle the volatile economic situation is not yet devised. This is in spite of sharing a common acknowledgement that private enterprises are the main driver for growth and development, and that African countries must drastically improve their investment climates. Donor countries have all promised debt relief and increases in ODA towards Africa, but one cannot observe a concrete and practical methodology to link the extra resources that arises by these measures to "poverty reduction through economic growth".

Therefore, the ultimate goal of this report is to devise programs to interconnect the private sector dynamism that has begun to emerge in Africa and true development by directing the effect of macroeconomic growth toward poverty reduction.

Figure 9.3: Per-Capita GDP in Sub-Saharan Africa (in 1990 constant dollar)



Source: UN Statistic Division Databases; FAOSTAT

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[104] One of the reasons for the success of South African corporations is that they are enjoying the "first mover advantages" by avoiding competition in countries in which corporations of other countries are not interested.

[105] Since NEPAD projects require huge amounts of funds and cannot be financed by ODA alone, inflow of FDI is being called for. The South African government and corporations, including public corporations, are fully aware that they are the most promising candidates to play leading roles in financing large projects, such as development of transportation infrastructure and electricity and in actually implementing the projects.

(1) Role of governments in private sector development

It is the corporate society, especially South African enterprises that is moving the current African economy and providing unprecedented dynamism to the economy. South African corporations come up with concrete measures in regard to problem-solution that are normally assumed to be addressed by government or public agencies, such as preparation of industrial legislation and stable supply of electricity. This is partly because waiting for governments of various countries to come up with a measure may result in lost time, and partly because SADC and NEPAD do not have the clout to induce public agencies to make decisions on an item-by-item basis.

The current rush in FDI was not brought about by changes in policies but triggered by an external factor, as previously described. The privatization of public corporations in various countries that was prompted by structural adjustment policies is no doubt one factor. But, it was the private sector that carried out important tasks, such as financing the purchases of public corporations' assets and building new management bases. Such entities that could not get business interest had passed away. It is more accurate to say that the governments, through the process of promoting private sector entry, have learnt the dynamics of a private economy.

Therefore, the role of governments in private sector development is to channel the efforts to the development of climates that allows for the full realisation of the dynamism that the private sector has. It is likely that the government's efforts for development of relevant climates are more effective when the private sector is still at infant stages. Business climates surrounding private enterprises can be split into (1)"external environments", such as macroeconomic environments, foreign economic policies and social environments; (2)"internal environments", such as management resources of an enterprise that compose the production and sales activities, and (3) what is referred to as "intermediate environments" which lies in between the two, such as policies that directly influence business activities, legal system, infrastructure, finance, information, human resources (UFJ Institute [2004]). The developments of external and intermediate environments are what are desired by governments. Therefore, technical assistance programs that Japan will participate in will be in this area of building capacity to for climate developments of the local governments.

Moreover, if one wants to focus on the cross-border dynamisms of the private sector, one should consider approaches that enable climate developments that cover a wider area than within the national borders. That is to focus on policy adjustments and implementations capabilities of regional cooperation through the frameworks of NEPAD, and SADC/SACU, and on capabilities of foreign cooperation with donors including Japan and international organisations. Improving capacities of African governments in this regard are also important.

However, as abovementioned, if African government agencies, who are the counterparts of technical assistances, lack the capacity to develop business environment for enterprises activities, one should not only target the governments but also consider cooperation approaches that directly work with the private sector and even with individual enterprises. The recommended directions of technical assistance discussed in the next section are based on such way of thinking. What is required here is to form a partnership with government agencies that directly deal with the activities of the private enterprises such as JETRO, JBIC and NEXI. In other words, the so-called "All Japan" approach is required.

(2) Linking local companies with foreign companies operating in the region

Most of the FDIs flowing into Africa are aimed at exploring resources and therefore are capital intensive and limited in terms of job creation. Since such FDIs require equipment and facilities incorporating advanced technologies, imports should increase and then initial investment will be financed by the earnings from the export of resources. In other words, many enclaves that have little linkage with each domestic economy will be formed in the continent. Since governments or the wealthy accumulates the income reaped by the African side from those enclaves such as royalties and stock dividends, it does not have the effect of reducing poverty[106].

Although many South African retail-distribution groups are already operating in other African countries[107], the local procurement ratios of the products they sell are still low. The range of goods available at South African supermarkets in African countries is on par with that available at shops in South Africa. However, except for perishable goods, regardless of whether they are European-made or Chinese-made products, they are first purchased by the head offices in South Africa and then delivered to shops in other African countries. It goes without saying that the majority of goods are made-in South Africa. Only Zimbabwean made products, Kenyan made products, or Nigerian made products partially substitutes some of them.

Tourism in southeastern Africa has been revived thanks to investment by South African capital. However, South African products account for most interior equipment and furniture. There are opinions even in South Africa, that is, businesses that do not bring benefits to the countries in which they are operating will lower the reputation of South African corporations and it would adversely affect their future business operations. A person in charge of a local branch was quoted as saying, “If there is no problem with regard to quality and quantity, we would like to purchase local products, as they obviate the need to go through customs clearance procedures and are free of tariffs.”

Here is a potential market for local corporations or local farmers. Although retail group companies cannot afford to establish a local production system[108], local producers can expect the emergence of specific and permanent buyers. Regardless of whether it is hotel, mining or other operations, they require a vast amount of items in addition to complicated and highly advanced equipment. They all constitute potential demand for local procurement; nevertheless, local producers are unable to meet the demand. If such is the case, there is room for expecting public institutions to fulfil their functions. If buyers specify quality and quantity, local corporations can expect to earn hard cash as long as they meet the conditions.

As previously described, unless a market is foreseen, corporations will not be motivated and technological cooperation for local producers will not yield desired effects. The conventional technological cooperation lacked consideration of market and demand to realize profits, and did not have partners in this indispensable aspect, namely buyers. That is, it has been looking only at the supply-side while any economy is constituted by demand and supply, and expectable demand did not exist for African producers. But these unfavorable conditions are being improved. That is to say, technical guidance to clear specific hurdles for business matching can be activated as an aid device in the new environment surrounding the African economy. If such technical assistance can be devised, the effect of such aid can be seen in the corporate accounts, which will facilitate the calculations and evaluations of aid efficiency.

(3) Support for FDI promotion

There are some limitations in public institutions and aid agencies when they try to take the lead in the initiatives in attracting FDI. As described earlier, the labour-intensive industry of Africa does not have comparative advantage and inducement for investment due to its high-cost structure. African countries do not have the conditions and economic strength to win in competitions with former China or present Vietnam. For these reasons, Africa was neglected by private investors and marginalized in the 1980s

[106] In its negotiations with IMF, Angola refused to disclose its oil revenues and use of the funds, terming the IMF’s disclosure request as “intervention in domestic affairs.” In this connection, it is noteworthy that Chad has enforced the Oil Revenue Management Law stipulating the use of oil revenues for medical treatment, education and rural development.

[107] The typical example is Shoprite Group. It is operating more than 300 outlets in 15 African countries.

[108] Since Nigeria bans imports of 60 items to protect its domestic industry, South African retail group companies planning to make inroads into the country are studying the possibility of establishing joint venture companies with manufacturers. They are apparently attracted by Nigeria’s huge market, however, the average population of African countries other than Nigeria is only 10 million.

and early 1990s, when labor-intensive industry was the main target of FDIs.

The current inflow of FDI into Africa is not being induced because of the labor force of Africa. Therefore, the kind of equitable increase in income that took place in Asia is not observed in Africa. Therefore, it is necessary to take the idea of "utilizing FDI" for the promotion of development as mentioned above.

Meanwhile, FDI in areas such as development of the electricity, telecommunications, and finance and infrastructure will enhance the economic strength of the areas invested in. The motive that prompts South African corporations to invest in other African countries may be the expansion of their own interests, or financing of South African business from which they can expect sure returns. Nevertheless, such investment results in improving the economic conditions of the FDI receiving countries.

However, a shortage of engineers and skilled workers is becoming a serious issue, as South Africa is forecast to face electric power shortage within their territory in 2007 and as the construction boom in the country is expected to continue until the 2010 World Cup hosted by South Africa. In fact, Eskom has begun to withdraw their overseas staff[109]. A plan to introduce construction workers and railway engineers from outside Africa is also being studied. Despite the strong willingness of South African corporations to invest in Africa, FDI from South Africa may decrease due to their lack of corporate strength.

If engineers and workers are trained[110], they are sure to get a job in that current situation. If FDI is further expanded through such supportive activities, basic infrastructure of African countries can be improved through continuing South African corporations' intervention. Whether NEPAD can achieve specific results or not depends on South Africa's technical and management capabilities to a considerable extent. If our foresight is correct, the technical training may well be considered as part of support for NEPAD.

(4) Cross–border perspectives

Many of the projects planned in Southern Africa or by NEPAD are cross-border operations. If we are to consider profitable infrastructure development in Africa, which is an aggregate of small countries, national boundary should not be an insurmountable barrier. If a new mining development begins in a landlocked country, naturally a route to carry out minerals from the mine has to be planned in order to make business profitable. Future construction of infrastructure in Africa will be based on profit making.

By the way, all African countries, with the sole exception of South Africa, are food-importing countries. Even Malawi and Rwanda, where farmers account for more than 80% of the workforce, import food grain of their staple crop or depend on food aid. One of the reasons for this is the fact that producing surplus crops is not in the farmers' interest[111].

This suggests that if any country in Africa succeeded in producing surplus crops, the potential markets would be easily found in its surrounding countries. It would mean that the foreign currency and the cost of food aid funds that have so far been flowing outside the continent would be converted into export income of that country. The biggest export opportunity for Africa suffering less export competitiveness does exist in Africa itself in the form of a potential intra-regional market. In fact, Zambia has drastically increased its tobacco exports by accepting white farmers who had fled from

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[109] Eskom has been virtually the sole corporation engaged in electric power development in Africa, especially in regions south of the equator. However, faced with the ever-tightening need for power supply in South Africa, the company is now contemplating withdrawing its staff abroad. The move will have major impacts on NEPAD projects in the future.

[110] As counterpart of technical training, Eskom's Eskom College and Spoornet's Rail Academy can be utilized.

[111] Input costs required to produce surplus crops are not worth the profit gained by the production and the optimal production point is at a point below the self-supporting volume.

Zimbabwe, and also achieved food self-sufficiency last year and is exporting maize[112].

Food shortage, which is a chronic cause of disease in Africa, cannot be solved without enhancing cereal productivity[113]. But in the process, food production could be transformed into a profitable business like, for example, in Thailand. Supplying foods to areas with food shortages via capital cities or ports is not the best way. In order to deliver foods to the southern DRC, the Zambia route is the best, and in order to deliver foods to the eastern DRC, the Uganda route is the shortest. It has been said that landlocked countries, like Zambia and Uganda, are disadvantageous in terms of economic development and in fact it has been proved by several positive studies. However, if these countries can be useful as food supply bases to internal areas in the continent, it can be said that they are in an advantageous position. And this is the path leading to poverty reduction through income generating among farmers.

The same can be said of fertilizers, an essential input for increased food production. Africa relies on imports for fertilizers as well as foods, and they are sold at prices about twice as high as in Asia covering transportation costs. Therefore African farmers do not generally use fertilizers, and it results low productivity. If Uganda succeeded in fertilizer production utilizing its endowed phosphate rock, the country would be able to not only meet domestic demand but also sell fertilizers to its surrounding countries.

Despite repeated proposals for the establishment of a regional economic system, intra-regional trade has not increased in Africa. This is because African countries are not producing mutually required commodities. Africa's industrial structure and productivity level are not strong enough to generate intra-regional trade. In the case of foods, for which demand is definitely existed, intra-regional trade will be created and this in turn would lead to transportation demand and then to road construction. These transactions would act as a seedbed for the creation of a distribution industry. Aid should capture the scattered agricultural trade that is starting to occur for example in Zambia as an important movement that has a potential to develop into a full-scale regional food trade activities, and one should actively assist in this area[114].

(5) Support for CSR

Prime Minister Koizumi advocated supporting corporate social responsibility (CSR) activities in Africa in his speech at the Asia-Africa Trade and Investment Conference held in Tokyo last year. The concept of CSR is not fully understood not only by aid agencies but also by Japanese companies operating in Africa. At the same time, however, corporations engaged in production activities in Africa, including Japanese companies, have been implementing social action programs.

Manufacturing companies operating in Africa are surrounded by unfavorable conditions. Workers' nutritional conditions are not good, they are exposed to the danger of infectious diseases, and educational training standards are low. Panasonic, which has been operating in Tanzania for 40 years, provides food allowance to its employees and shoulders the entire medical expenses. Japanese companies in South Africa implement HIV/AIDS programs for its employees and for their community. All corporations above a certain size have been implementing HIV/AIDS programs at their own expenses[115], and some of them are expanding the programs to surrounding communities. The

[112] Farm productions by immigrant farmers from Zimbabwe are also beginning in Mozambique, and in border regions of Mozambique, Malawi, Tanzania, etc., agricultural goods are traded across borders.

[113] It is important to learn from the histories of Green Revolution of Asia and Latin America, when considering what the effective assistances for increased food production through improved crop productivity are.

[114] Agricultural trade in plantation style agricultural production by European farmers in Zambia and Mozambique and in others regions are very different. However, what is important in this case is that by exporting to neighbouring markets, incentives towards productivity improvements will arise. This in turn may enable a departure from the "low income frontier" (Hirano [2001]), where farming communities are not even self-sustainable. From this regard, a large scale farming style is not necessarily required. Rather, it is likely that agricultural processing and distributors work more efficiently that would then develop markets and information, as well as technology in a small local farm.

[115] In South Africa, corporations are responsible to HIV/AIDS matter among their employees and the governmental program

corporations are also engaged in activities to support crime prevention and school education. In fact, it appears that CSR has been incorporated in the South African business community.

These activities are not so much based on management's philosophy or goodwill as necessitated in order to maintain and develop businesses in the societal reality of Africa. The company suffers a heavy loss from its any employee's death of AIDS, for whom the company spent a long time to train and foster. In order to protect employees, the company is willing to take measures to prevent it, and has a wish to extend support to the communities in which the employees live within its budget limitation. If working efficiency does not increase and unscheduled absence becomes conspicuous due to malnutrition, the company has to consider compensation other than the wage. Japanese companies recognize these costs as unique to Africa and treat them as such. This "Africa cost" is one of the reasons why privates companies, when weighing the advantages and disadvantages of investing in Africa, often choose not to select investment in Africa.

Companies operating in Africa are shouldering this cost because they dared to invest in Africa. And the good effect of their CSR activities has been benefiting the public at large. Then we can expect the following three effects by inputting ODA as Koizumi advocates in this field:
1) Contribution to the enhancement of social welfare in industrial districts
2) Promotion of investment as a result of lessening the Africa cost shouldered by companies and influencing in-house investment decision- making
3) Creation of evaluation that inroads made by Japanese corporations will improve surrounding communities

In order to ensure the above effects, expected CSR support should be provided universally. Even if there is only one Japanese company in a certain African country, ODA should be provided based on the application by the company. The company should decide specific contents of the CSR activities based on the local situations, and ODA should be provided to take a part of the CSR cost from the standpoint of pubic-private collaboration. From social support through public-private collaboration, we can further expect the following two effects in terms of more efficient use of an ODA budget.
1) Implementation of ODA can be entrusted to experts within the company.
2) The effectiveness of this aid will be presented in periodical figures in corporate.

9.2. Technical Assistances Recommended

Based on the direction shown in the preceding section, we shall address Japan's supporting measures necessary for development in this region more specifically as follows:

<u>a) Linking local companies with foreign companies operating in the region</u>

The aim of this is to provide assistance to foreign enterprises especially South African enterprises located in countries in this region, to enhance the capacity of product and human resources provisions. In other words, this means an incorporation of local economies into supply chains of foreign (South African) enterprises. For these purposes it is absolutely necessary to enhance their production capacity quantitatively as well as qualitatively to the level required by such foreign enterprises and to allow them to access purchasing route of the same. More specifically the providing the following assistances in descending order can be recommended:

- To assist the formulation and implementation of appropriate industrial policies (to set up regular meetings with foreign companies based in the region, domestic producers and governments, and to select local industries that can supply goods to foreign enterprises, and to formulate a master plan (industrial policy) to improve the productivity, the quality, and the price competitiveness of a given industry through the partnership of private and public sectors.

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for it covers only non-employees.

In addition, to improve the capacity of government agencies to allow its implementation);

- To assist local industries in respective countries to foster and develop human resources (assistance in improving the management and production skills of producers and distributors through domestic economic bodies such as the chamber of commerce); and
- To assist financial institutions to grant loans to private sectors (establishment of financial access mechanism (including evaluation and advisory functions) for producers, including the distributors and funding supply functions of foreign enterprises in respective countries).

When advancements are achieved with the above measures, one can pursue measures such as to hold a function to match local enterprises with foreign enterprises, and to link producers to markets through business transactions.

b) Assisting FDI promotion

This is assistance for South African enterprises to make FDI in social infrastructure in this region. For these purposes we should consider following projects:

- To assist South African enterprises to foster and develop human resources; and
- To assist South African enterprises to transfer their infrastructure development schemes to countries in this region.

In view of promoting FDI by other TNCs, it will be necessary to improve investment climate more generally. For these purposes following measures are to be considered:

- To assist respective countries to conceive trade and investment strategies; and
- To assist respective countries to develop their social infrastructure.

c) Giving support to CSR Activities

It is necessary to give support to community activities by Japanese or third country businesses in Africa in order to alleviate investment costs incurred by them and to promote social welfare in this region. More specifically:

- To assist enterprises to conduct prevention and care activities of HIV/AIDS

in a way appropriate for their respective business fields.

d) Cross-border perspectives

This is measures to promote intra-regional trade of foods and fertilizers. From the viewpoints of technical assistance to increase agricultural productivity for export purposes and to increase capacity of distribution between two countries or within the region, it is necessary to enhance:

- Support of infrastructure development and research/mitigation of factors that impedes to the trade with the region (re-examination of uncompetitive goods transport policies, facilitation of custom procedures, etc);

and in view of various regional trade promotion, the following are necessary:

- Support trade and investment promotion, and agriculture related programs at the SADC level:
- Support for market research by country with focus on demand of the food and the distribution structure.

In addition, in order to enhance supplying capacity of foods and fertilizers, or wider range of local products to be distributed regionally, the tasks above mentioned in the fields mentioned in a) should be studied.

In light of the above mentioned general recommendations, we describe below the issues and practical assistances that Japan should provide. It will be examined from the perspectives of (1) priority issues to be tackled; and (2) issues to be addressed in the medium- to long- term. Finally, recommendations of assistance measures will also be provided from the region-wide perspectives.

9.2.1 South Africa

(1) Issues for Private Sector Development

Although South Africa's economy is the most advanced in Sub Saharan Africa, the exclusionary nature of Apartheid and distortions caused in part by the country's international isolation have left major weaknesses. The economy is now in the process of transition as the government seeks to address racial inequalities, to stimulate economic growth and to create jobs. High unemployment caused by the vast unskilled labours who are unable to adjust to the transition towards capital intense industries have created serious deteriorations of public security in urban areas. This has been a factor in holding back investments for some foreign enterprises. Furthermore, shortage in skilled labour, and calls to increase black people as entrepreneurs and in managerial posts through the BEE policies have also made labour environment difficult for foreign enterprises.

South Africa is an important investor for SADC, and it has been diversifying its investments from the traditional resource development sector to service sector including retail and infrastructure. However, even South African enterprises with good knowledge of regional conditions are also stricken by the poor business environments of the countries they invested in. In this regard, investment climate developments at the SADC level are important both for the South African government and for the business world. Additionally, even though South African national enterprises such as Transnet/Spoornet, Eskom plays an important role in the infrastructure development and management of the SADC region, due to the shortages of highly skilled and experienced labour as mentioned earlier, they have started to become hesitant in expanding outside South Africa. Moreover, South Africa is a world's fifth most HIV/AIDS infected country. Due to the delay in the measures by the government, private enterprises have started to play an important role in the prevention and treatment of HIV/AIDS, but this has been factor to increase business costs for enterprises.

(2) Practical Assistance Measures

1) Priority issues

- Assistance for South African enterprises to foster and develop human resources

Technical cooperation to foster a considerable amount of technicians in the electricity and transport etc, sectors at an early stage to go outside of South Africa to contribute to infrastructure building and maintenance of South African region. The counterpart of this assistance will be South African business entities. In particular, to provide technical assistance towards existing human resources development facilities owned by enterprises (such as Eskom College, Spoornet Rail Academy, etc). (This measure is primary an assistance towards South Africa, however, due to its positive impacts through a much wider region, it can be considered as part of NEPAD assistance.

- Assistance for foreign-affiliated enterprises in this region to foster and secure their human resources.

In South Africa, where there is a serious lack of human resources with adequate skills and expertise, opportunities of technical and financial assistance to human resources development to be performed by foreign-affiliated enterprises are to be considered. Association of Overseas Technical Scholarship (AOTS) has been sponsoring seminars for engineers and executives from developing countries with Government subsidization, but it activities have only recently started in Africa. It is advisable to disseminate information widely on AOTS's seminar services and promote human exchange and networking among African and Asian countries through its seminars (especially overseas seminars). For example, seminars in South African automotive industries would be expected to promote overseas investments by automotive manufacturer-affiliated enterprises and automotive parts manufacturing companies because of increased supply of talented human resources concerned and to transfer automotive technologies to this region from Asian countries as relatively advanced production bases of automobiles.

- Support of corporate anti-HIV/AIDS measures

Provide support for HIV/AIDS which is now a pressing issue, in communities where employees of Japanese enterprises live, for example. In addition, from the perspectives of labour health and security, support the activities of South African governments in HIV/AIDS preventions measures at workplaces (Japanese affiliated firms as well as local enterprises).

2) Issues to be addressed in the medium- to long- term

- Support for South Africa's infrastructure development scheme transfer promotion (Support towards technology transfer of South Africa's PPP scheme to SADC countries)

In connection to the technology transfer (capacity building) of PPP Scheme for SADC countries by the South African Department of Finance, to conduct a joint study between South Africa and respective countries on the relevant legal system, capacities of the implementing agencies, procurement structures of the respective countries and to support the implementation of the South African PPP or its modified schemes

- Support of conception and implementation of appropriate industrial development strategies (capacity development of government organisations related to SME)

In order to revolutionalize the labour market structure posed with high unemployment and human resource shortages, it is vital that one deals with the mid- to long- term issues of fostering local industries and human resource development. South African government has already placed various incentives and streamlined policies and organisations for SME promotion. However, it is thought that improvements in technical assistance towards SME per se are required. In this regard, a grasp of the actual level of technical assistance and to provide assistance to improve the government technical assistance organisations and SME governing agencies are required[116].

9.2.2 Zambia

(1) Issues for Private Sector Development

Zambia has achieved an average of 4.6% of GDP growth annually between 2001 and 2004, its problematic national budget conditions have shrunk to 1.7%, and due to booming export sectors, its domestic currency kwacha is stable. Moreover, out of its US$ 7.2 billion external debt, US$ 3.8 billion is expected to forgiven, and this has contributed to the macroeconomic stability.

The rise in the international prices of copper can be mentioned as one of the factors for its recent success. However, private sector development in a wider sector is necessary in order to aim for stable economic growth that leads to poverty reduction. Departure from the copper reliant economy, in other words diversification of industries and issues of financial accessibility which is a major impediment to private sector development must be dealt with. In addition, resource processing manufacturing industries and tourisms are also industries that should be fostered. For such private sector development, domestic resources are not adequate and in this regard, FDI promotion is a pressing issue. This requires the development of weak infrastructure and legal structures.

(2) Practical Assistance Measures

1) Priority issues

- Formulation of industrial strategies

Assistance in departing from the copper and cobalt reliant economy, in other words, to formulate and

[116] JICA (UFJ Institute [2005]). The Small Enterprise Development Agency which was formed as the sole regulating organisation for policies related to SME by consolidating existing SME support organisations. Capacity development of this agency and the national network of bodies directly under the agency are vital. It is also important to provide support to private bodies that play the central role for SME assistance through the provision of business development services (BDS).

implement strategies to diversify its industries, must be implemented now when the copper prices are high or it will lost its right timing. Agriculture is one sector that should be given more attention. Currently, only about 15% of the 600,000 hectares of cultivating land is used, but the country has good ample water and favourable weather conditions.

To encourage investment in agriculture and to foster import substituting and high value added export agro processed product businesses in order to fulfil domestic demand and also to supply food to neighbouring countries as the "bread basket".

Another pillar for diversification is manufacturing that uses domestic resources. Copper sticks, copper wires, wood products, leather products can be tackled at the SME level. In addition, strategic approaches to tourism, fishing, and infrastructure related activities are also desired. These fostering of industries should be done alongside FDI promotion strategies in a manner that will result in private sector development. In this regard, it is vital that the "New Deal Policy", which is already formulated but has been indicated to lack adequate commitments, are properly implemented and a that strategy (e.g. linkage programs) to promote linkages in FDI and local industries in priority industries such as agriculture, manufacturing, and tourism are formulated.

- Support to encourage grant loans to private sector

The biggest constraint in promoting private enterprises business activities is the funding. Currently, access to bank loans by private enterprises is limited to short-term credits including trade financing. It is very difficult for regular enterprises to raise medium- and long-term funds. Even for short term finances, the interest rates are extremely high (Kwacha loans are around 60-80%pa) and in addition require high commissions. It is only a very small number of fortunate enterprises that are able to secure finance from banks and the vast amount of SMEs do not have access to any formal funding. The Bank of Zambia (central bank) considers the problems of access to funds the largest problem for private sector economic growth, and is examining the possibility of a capacity building plan for private commercial banks to increase the fund provision capabilities. As Japan's assistance measures, it can provide technical assistance to the central bank (its counterpart) and support measures to improve private enterprise loan by including private commercial loans.

- Support to development infrastructure in sectors such as transport, irrigation and electricity.

In terms of the potential for agriculture and agro-processed products, Zambia may be lucky compared to many of its neighbours, but the road and transport infrastructure to transport these remain underdeveloped. It is clear that this has had negative effects of FDI promotion. Japan has already been assisting in the areas of road and electricity, however, a basic plan of infrastructure development that is consistent with the industrial policies and places high values networks between neighbouring countries, and policies to enable the implementation of PPP should be discussed.

<u>2) Issues to be addressed in the medium- to long- term</u>

- Support to establish finance related basic infrastructure

As mentioned above, the biggest bottleneck for financial institutions in promoting private sector is the lack of basic financial infrastructure. In particular, SME related information is scarce and there is a no legal system to guarantee and protect the lenders. In terms of assistances in information, an establishment of "Credit Bureau ", and to provide assistance through the central governments are required. In addition, Bankruptcy Law is vital and assistance towards its formulation is required. In addition, for SME loans promotion, the establishment of guarantee agencies at the public sector is also a possible assistance area.

9.2.3 Tanzania

(1) Issues for Private Sector Development

Represented in the Arusha Declaration 1967, the late President Nyerere's high philosophies left glorious remarks in recent African history. In terms of the economic situation, however, it was in shatters and in the 1980s it can be described as being bankrupt. The departure from there started with the political and economic reforms of the former President Mwinyi, and the stable growth trend has been set under the current President Mupaka. FDI inflows are also doing well and the Tanzania Investment Center (TIC) has won the top prize for the 2004 Africa investment promotion organisation competition.

The transformation of a typical African socialist country with a one-party dictatorship and a poor agricultural country that did not have any industrial basis because the country was build as a colony to provide agricultural primary goods, to succeed in regaining economic growth through political leadership has been highly acclaimed both within Tanzania and from abroad. This is clear from the fact that the President Mupaka was invited to be one of the UK's Commission for Africa's commissioners.

The problem of Tanzania's economy is that it lacks general economy strength. Highly quality labour force is limited and in general their skills and education levels are low. Infrastructure development is also delayed thus electricity costs and transport costs are high and corruption is problematic at the lower end bureaucrats. In other words, Tanzania's recent economic recovery is driven by foreign investment as a result of opening up of the business chances, but these entries have not targeted the production factors within Tanzania, such as domestic labour force. Thus, these have not resulted in increased country's strength nor has it led to poverty reduction.

Therefore, the issue for promoting private sector development is to firstly increase the quality of the domestic labour force to be able to compliment the movements of foreign investment and to devise mechanisms to reduce poverty through FDI. FDI promotion measures can only be used for ODA purposes when economic growth and development promotion can go hand in hand.

(2) Practical Assistance Measures

1) Priority issues

- Support for local procurement promotion by foreign companies

Foreign companies in Tanzania, in mining, tourism, manufacturing, retail, etc depend heavily on imports for a wide range of goods and equipments used. For example, the retail group in South African has opened the first supermarket in Tanzania and is looking to expand its operation. However, except for fresh produces, all products are imported from South Africa, Europe or China. Importing these items even though the group has to pay customs is because local production quality does not meet its procurement standards. If this gap can be filled by technical cooperation, the profits will definitely be received by the local enterprises and farmers. If one can succeed in opening up such procurement channel, there will be a link between FDI inflows, poverty reduction and development promotion. If domestic demand can be built in the project and private buyers can work together, a technical cooperation project with a clear path to income creation and a concrete objective can be established.

- Support for CSR activities by Japanese enterprises

Panasonic and JT are the two Japanese manufacturers currently working in Tanzania. In order to maintain its operations under tough environments, both companies are operating or conceptualising a program that extends far beyond normal business activities. JT has a HIV/AIDS measure for employees that distributes anti-retrovirus drugs free and provides assistance to tobacco producers. Panasonic covers all medical costs of its employees and also provide food allowance separately. These activities have the potential to expand into community assistances and by doing so, one can expect further effects. If CSR for communities can be evolved in this manner through the public and private cooperation, investment will be promoted through lower African cost and Japan can establish a reputation for improving community health problems when there is entry by Japanese enterprises.

2) Issues to be addressed in the medium- to long- term

- Development of regional food trade

Tanzania is an agricultural country, with 80% of the labour force is involved in agriculture. Historically, it has established the country through agricultural development. Japan has put in many assistance programs to assist Tanzania's agricultural development. Unfortunately, these were not successful, but it is vital that farmer income is increased in order to achieve poverty reduction. Can innovative agriculture development support measures be devised by newly adding the Green Revolution methods and foreign currency earnings by trade? If a food trade with neighbouring countries are fixed, a sustainable establishment of transport infrastructure will be conceptualised and enterprises involved in food distribution can be born.

9.2.4 Madagascar

(1) Issues for Private Sector Development

Between the end of 2002 and the first half of 2003, Madagascar was in political turmoil which created political and social chaos, and economic downturn. However, since then the newly elected President Ravalomanana has pursued reform policies forcefully and quickly, and this has enabled a quick transformation towards market economy and transparency of governance. In recognition of this, international community has increased aid towards Madagascar. In addition, debt relief has also been promised and thus external environments for Madagascar is picking up favourably. Economic activities have gradually normalized and recovery can be seen in the number of tourists and in FDI. Madagascar has recorded a real GDP growth rate of over 5% since 2003 which is above the average of Sub Sahara and of SADC, and in 2005, it is predicted that the GDP per capita by PPP method will hit the highest since the 1990s.

On the other hand, poverty reduction which is the common issue for the government, donor countries and organisations remain problematic in many dimensions. In agricultural villages where 70% of the population live, there are no significant industries except for primary industries and some selected tourism, and there are little employment opportunities. There is also a wide disparity between rural and urban areas in regard to basic infrastructure development including electricity, clean water, communication, road networks. In order make use of Madagascar's unique regional products and industries and to foster the private sector, one must promptly fill the infrastructure gap that impedes the production and distribution activities. From the industries viewpoint, agriculture, fishing and forestry which account for the employment opportunities for 80% of all labour force, especially productivity increases in crops which is not only the staple food but have a potential to complement regional food trade, restructuring of appropriate and effective distribution sectors, and market formation are the main issues. Amongst secondary products, many investments both domestically and from abroad are planning a full scale entry in mining sectors that are thought to possess extremely high development potential. Thus, one must focus on ensuring transparency in legal framework and support for development of incidental infrastructure that may because impediments to investments, and harmonisation of the surrounding environments and development. In the industrial sector, it is desirable to formulate private sector assistances and fostering measures to fortify its weaknesses and to increase entrants in sectors where Madagascar possess some industrial cluster, competitiveness, and raw inputs such as agriculture and fishing processing sectors, and textiles. In the tertiary sector, the current administration intends to develop and restructure the public service industry, where even though there were high needs for its use, it was ineffective and have been managed by national monopolies. This is said to be achieved by gradual transfer to the private sector, and through PPP. Thus, cooperation in finding suitable new PPP will be desired. As cross-sectional industry measures, integration of domestic market, participation in regional economic blocks and exploitation of international markets are expected to go underway with Ravalomanana's reformist path. The formulation of a more appropriate industrial, trade and investment promotion strategies, the development of a necessary legal framework and strengthening of its enforcement powers, human resource fostering that are necessary both for private and public sector, improvements of the quality and quantity of financial services that will be required for start-ups and for new and additional investments should all be tackled with a long term perspective.

(2) Practical Assistance Measures

1) Priority issues

- Human resources contribution towards the formulation and implementation of industries, trade and investment strategies

Madagascar government emphasises agriculture/fishery and their processing industries: which account for a large proportion of the labour population, mining: which has the potential to become a strong foreign currency earner, tourism: to profit from the unique and diversified plants and animals, (export) manufacturing: based on EPZ, and infrastructure building, public service industry fostering and its promotion. These are all rationalised through its use of existing resources, and, cheap and plentiful labour force. However, concrete measures for industry fostering have not gone beyond the private and public discussions and the numbers of enterprises that may be responsible for each industry are limited. In addition, legal framework, incentive measures the development of government implementation bodies to facilitate and encourage start-ups and investments are still ongoing. Under these circumstances, the government is planning new policies and institutional framework through the Presidential Office that is independent from the ministries. In this process, the government is trying to depart from the heavy reliance to France and is actively recruiting foreign advisors from countries that are preeminent for the policy area in terms of expertise and experience. In this regard, an economic advisor to assist in formulating the industry, trade and investment promotion strategies from Japan is also desired.

2) Issues to be addressed in the medium- to long- term

- Comprehensive assistance in agriculture, especially in rice production

As discussed in the previous section, productivity improvements in agriculture, especially in the production and strengthening of distribution mechanisms of rice, which is a staple crop, have positive impacts on improvements on the rate of self-sustainability of food, stabilisation of domestic economy (restraining inflationary pressure, increasing domestic demand), balance of payments improvements (keeping down food imports, increasing exports). In addition, it will contribute to the fostering of private sector in a broad sense, and thus it is a pressing and important issue. This problem cannot be solved simply by focussing ones efforts in increasing the yield. It is only effective when strengthening of related industries, raising the general level and infrastructure development, restructuring of the distribution structure and new market exploration can all be achieved. Three specific recommendations are presented below:

1. First, in order to assist the stability of rice production and the increase of productivity, establishment of rice crop research and dissemination centre (and affiliated offices in each state) for the development and use of breed improvements and new variety, fostering of farming trainers, and strengthening their assignments breed improvements. In the dispatch of experts, technicians and the necessary resources and equipments, one should not only select them from Japan, where it plays leading roles in mechanisation of agriculture and technological innovations, but from South East Asian countries where it has achieve success in increasing the yield per unit.
2. Second, one must strengthen the surrounding industries of rice crops. Japanese enterprise is currently planning a large scale mining development. During this process, potassium mineral which is used as fertilisers was found underground and an establishment of a fertiliser factory is now being considered. The use of fertilisers is vital in trying to increase yield per unit. Support in the application of public loans and investment insurance and in the development of the necessary infrastructure will be effective in starting fertiliser production projects including F/S research. In addition, regarding agricultural machinery, which are equally important, it is better to focus on providing training for its use and for maintenance through the establishments of training and maintenance centres and through fostering of necessary human resources and the dispatch of experts required, rather than to focus on providing more machineries.

3. Third, the fostering of distribution enterprises which will be required in purchasing, transport, sales, and exports of rice. In Madagascar, a platform which is to be made up by all players in the rice sector to hold meetings and to increase transparency of distribution structure and price setting mechanisms are currently being considered. As for new assistance, practical measures are to facilitate the link between accumulated funds and trade routes by distributors to production and export of rice. Training course in successful Asian rice exporting countries on management and practical trade practice, support for market research in the Southern African region, support to establish loan mechanism to when investing in production and processing sector, are some examples of assistance in this area.

These measures are to be applied to other important major agricultural and fishing products and processed food either after the measures for rice are implemented or alongside the assistance to rice.

- Support for infrastructure development and development projects

As abovementioned, maintenance, repair and strengthening of basic infrastructure that had been abandoned since independence from France not only lead to increases in living conditions in the rural areas but is vital for the revitalisation of local economy and the private sector, and for the trade and investment promotion. Many donors and organisations are currently providing large scale assistances in areas of highways, railway network, electricity network and development of water supply. Especially in urban areas, there have been visible accomplishments. As regards to infrastructure development assistances by Japan, sufficient result and recognition can be achieved by coordination and role sharing with other donors and the Madagascar government, and by pursuing assistance in an effective and sustainable manner.

On the one hand, when thinking of infrastructure development, it is not only the completion but the views on maintenance are vitally important. Currently, whether they are public or private, in existing infrastructure operating entities, there is a shortage of technicians and cost managers which are vital for maintaining quality of the service provided. In addition, there are shortages of enterprises in the construction and civil engineering sectors that are responsible in constructing various infrastructure, and, public and private establishments, who are able to be achieve the required standards and delivery date. Fostering of civil engineers and entrepreneurs in this field will merit greatly from Japanese cooperation through PPP, taking account its high growth of infrastructure development programs, geographical climates characterised by it high risk of damage by wind and flood. In particular, tertiary high schools specialised in civil engineering techniques, and/or building and enlarging vocational training schools, and dispatch of experts and technicians, and dispatch and provision of equipments and resources are recommended. If the "Japanese standard" is applied and can be rooted in the infrastructure development of Madagascar, it may bring some benefits to the Japanese industries, including through the procurement of necessary equipments and resources required in maintenance.

On the other hand, Japanese enterprises have started to show entry in large scale development projects especially in Madagascar's agriculture, forestry and fishing industries, and in mining. However, it will likely to require its own funds for the development of some necessary infrastructure including electricity, water, environment preservation establishments, road and ports, and in securing and fostering of human resources. Concentrated injection of public funds in the provision of resource subsidies, loans and insurance at project launch, vocational and language education, and infrastructure development that targets the whole community, will lower the cost of entry of enterprises. This will lead to a development of living environment and human resources development, which in turn may spur more new entrants. Thus, this will create a virtuous circle.

9.2.5 Malawi

(1) Issues for Private Sector Development

Malawi is a landlocked country and is defined as one of the poorest country. The economy is highly dependent on agriculture with approximately 35% of GDP in agricultural production. 70% of agricultural products are produced by small dirt farmer. Although the land is relatively bountiful compared with surrounding countries, their productivities are low because approximately 40% of dirt farmers cultivate land that is less than 0.5 hectors in size. Approximately 90% of imported goods are food and agricultural raw materials.

Malawi government steers the economy towards a market-oriented one and, at the same time, proceeds educational reform, environmental improvements, reduction of HIV/AIDS, and establishment of fiscal discipline. In particular, over the short-term run, although tobacco industry, approximately 50%'s share holders of export of the country, has been promoted structural reform by the government, it can not break away from the violent fluctuation at international marketplace and from the uncertainty of weather change. Therefore, essential diversification in agricultural production is required. In addition, the economy is supported by multilateral and bilateral assistances. In fact, debt are reduced by HIPC Initiatives in 2000 and received famine relief with 50 million US$ from the World Bank on November 2002.

Malawi economy has shown some prospects of macroeconomic growth in the mid 1990s, however, this has slowed down considerably since. Delays are especially prominent in controlling expenditure and in breaking away from its high dependency on agriculture. Exchange rate fluctuations and increases in inflation rate and real interest rate are emerging as impediments to corporate activities. The newly elected president Mutharika (since May 2004) is focusing its efforts on the containment of expenditure and on the alleviation of corruption. Especially in the areas of expenditure controls and downsizing of the government, have contributed to some successes in the Malawi economy. However, its source of government revenue remains heavily dependent on foreign aid, and improvements on this is desired. Consequently, its economic policies are strongly influenced by the IMF. The IMF is demanding the Malawi government to strengthen financial discipline through increased capacity of tax collection etc., in order to achieve curbing of inflation and new debt, and increases in funds for the private sector. The government in response has reduced tariff rates to an average of 14% as well as facilitated the system, and has eased the import restrictions. Concerning strategies by sector, the existing strategies such as free distribution of seeds and fertilizers to micro-farmers in case of drought, development of tourist infrastructure are mostly short-term strategies. Improvements in the capacity to carry out public administration and government, in order to formulate medium-term, strategic industrial policies, are issues to be tackled.

(2) Practical Assistance Measures

1) Priority issues

- Capacity building for the formulation and implementation of trade and investment promotion policies and institutions

Malawi has been pursuing liberalisation of trade and investment. It has adopted the "Integrated Trade and Industry Policy", "Competition Policy and Legislation", "Cooperative Policy and Legislation", "Micro and Small and Medium Enterprise (MSME) Development Policy", etc, and has worked on maintaining the international competitiveness of manufacturing, and the enlargement of the private sector which forms the basis for economic growth. In addition, by creating EPZ, it is attempting to provide incentives to investors in order to increase exports. Furthermore, through the Investment Promotion Act of 1991, it is promoting investment into the country.
However, it is hard to say that these policies and institutional frameworks have produced the successful results. It is assumed that the main problems for this are the lack of feasible plan of action to implement them, and that lack of administrative capacity. Thus, one needs to urge the formulation and the implementation of trade and investment promotion plans through development research and dispatch of experts.

- Strengthening of investment promotion of organization and information provision in order to promote industries with exporting potential

Due to its rich soil relative to its surrounding countries, Malawi was said to easily achieve "take-off", once its political system is improved. As the government eagerly pursues economic development, diversification of trade products is urgently required. However, given current capital stocks, it is not easy to generate internationally competitive products. It is thus clear that it requires direct investment from abroad.

Malawi is promoting investment through MIPA (Malawi Investment Promotion Agency), composed of private enterprises and government representatives. However, it is hard to say that it has sufficient functional capacity. In addition, in order to supply Malawi goods in the international market, Malawi should accept missions and short term experts, and participate in trade fairs, with the assistance of JETRO.

- Agriculture promotion and training of people involved in agriculture for diversification of agricultural products.

Even though Malawi has rich soil, it is heavily reliant on tobacco production. Diversification in order to gain foreign currency has been delayed. Agriculture promotion policies and institutions clearly oriented towards three types of diversification, namely, diversification of products varieties, quality diversification (through clarification of high value added products and low value added products), and diversification of trade partners are required. In addition, with apparent comparative disadvantage emerging from agricultural production by small dirt farmers, the establishment of education/training policies and institutions of people involved in agriculture is rapidly called for.
Thus, assistance focussed on the establishment of agricultural promotion policies and institutions, as well education towards people involved in agriculture are desired.

<u>2) Issues to be addressed in the medium- to long- term</u>

- Infrastructure development (development of road network)

Malawi has achieved privatisation in many economic sectors, including the areas of infrastructure such as road, communication and electric power. Out of approximately 100 public enterprises subject to privatisation, over half has already been privatised. However, it is also true that the landlocked nature of the country, has made transport costs high, which in turn has been lowering international competitiveness.
This has long been acknowledged. It firstly needs to implement the Nacala Corridor project. This has been identified as the core project for infrastructure improvements. Thus, through development research, the clarification of the feasibility of and the exploration of the possibility of yen-based loans should be pursued. At the same time, since small and medium sized infrastructure projects that is expected to follow from the Nacala Corridor project is said to induce the use of the private sector vitality, development studies to understand what types of policies and institutions will achieve this. This should be followed by proposals on yen based loans to implement feasible projects.

9.2.6 Angola

(1) Issues for Private Sector Development

Angola is the largest recipient of FDI in Sub-Sahara Africa between 1993 and 2003, but it is heavily reliant on the oil sector. The government is seeking to expand the investment into non-oil sector, but shattered infrastructure due to the prolonged civil war is a serious impediment to this. Angola also remains reluctant in responding to the calls by IMF to increase governance and transparency on its national budget. This has made developed nations hesitant on providing ODA for infrastructure development purposes. Therefore, China has been taking a monopoly in infrastructure development in this country.

Even though Angolan government has organised the framework for investment through the establishment of the investment promotion organisation (ANIP), intended to a "one-stop-center" for investors, it has not totally removed the barriers of corruption and bureaucracy. As a result, Angola's investment climate can be described as "high risk, high return", and it has become one of the most difficult Sub-Sahara African country to invest in.

(2) Practical Assistance Measures

1) Priority issues

- Organisation of planned projects and urgency study of infrastructure projects

In a country like Angola where it is in the middle of reconstruction in the aftermath of war, the formulation of a mid- to long-term infrastructure plan that corresponds to its development plan is required. In view of the full scale infrastructure that development that is expected on the condition that relations with IMF-World Bank improved, by clarifying short-term plans that are already being implemented as well as mid- to long-term plans, one can increase the predictability of projects that is likely to be notified and thus will able to promote entry by enterprises in infrastructure development sector. Angolan government has already started the consideration of medium term plan (2005-2007), and long term plan (2005-2025). It is necessary that based on this one organise all the planned projects and select their urgencies. This will enable a prioritised development assistance of respective infrastructure including electricity, water, communication and transport.

- South-South Cooperation (Capacity building of trade promotion organisations)

As noted above, even with the establishment of investment agency (ANIP), it has far from achieved an effective procedure for investment. Thus, capacity building by their Asian counterparts, including Malaysia, Thailand, Indonesia, through dispatching experts, holding seminars in recipient countries, delegating countries or third countries, are required. Seminars may also be held in Japan or in South Africa.

2) Issues to be addressed in the medium- to long- term

- Capacity building in private sectors through chamber of commerce and industry

Through the "Angolanization" policy, it is effectively obligated for foreign enterprises to form partnerships with local enterprises. The Chamber of Commerce and Industry in Madagascar contribute much to capacity building in private local industries constituted mainly of SME. This is to provide technical assistance in areas of research, marketing, products development, export strategy planning, and business management skill training, in order to strengthen various services (business development service) to its member enterprises

- Support in enterprises' better compliances of laws

In Angola, it is thought that corruption is a serious impediment factor for investment for enterprises. As enterprises are increasingly emphasising corporate social responsibilities (CSR), compliance with laws and regulations has become an important element of it. In countries where not only bribery but where child labour dominate, it is not easy for prospective investors to determine entry, even despite abundant potential business opportunities. Enlightenment activities are necessary to publicise how there may be adverse effects by corruption and child labour on investments, from the viewpoints of enhancing business climates generally. Holding seminars is also to be considered as an option.

9.2.7 Mozambique

(1) Issues for Private Sector Development

Mozambique’s success in the macro economic reform brought striking economic growth (GDP growth rate between of over 8% between 1992-2004), which was the highest in all of the African countries at that time, and it produced some impressive growth in FDI, exports and tax revenue. However, whether it could maintain this rapid economic growth depends on success in some large-scale investment projects, continuous economic reforms and the revival of agriculture, transportation and tourism sector.

Although Mozambique's investments acceptation system has improved a lot, there remain many barriers such as tangled and inefficient bureaucratism and outdated legal systems. Moreover, there are outstanding barriers for investors such as the delay of the development and renovation of transport infrastructure, very weak labor market, l labour laws, extremely biased for labours and world's leading HIV/AIDS-infection rate.

(2) Practical Assistance Measures

1) Priority issues

- Support for fostering and securing of human resources of embarking companies.

Although the problem of lack of skilled workers in Mozambique takes long-term efforts at improvement in the educational level, job training at South African companies which hold dominant positions in FDI market and at foreign companies in Mozambique is expected to produce certain effects for the problem during the short time and that kind of efforts are essential. Moreover, job training at MOZAR, in which Japanese companies also take stakes, is said that it makes significant progress. Thus, assisting such development of human resources at foreign companies as well as at local suppliers of these foreign companies should be considered.

- Support for corporate HIV/AIDS measures

It can be said that the need for HIV/AIDS measures is an urgent issue like South Africa or even more urgent in Mozambique, and lots of enterprises address this issue. Therefore, it is necessary to link the HIV/AIDS program carried out at rural and community level by ODA with the activities at the corporate level, and to consider and carry out what medical facilities and supports of materials and human resources should be for realizing more efficient and seamless treatment at local level.

2) Issues to be addressed in the medium- to long- term

- Capacity building of private sector through the chamber of commerce

Although human resources development training at foreign companies are directed to development of skilled labour, private sector development through the chamber of commerce is mainly concentrated in management which is often said to be deficient in entrepreneurship and management skills. In Mozambique, it is necessary for the chamber of commerce to develop a system that provides business development services for member companies. As the next stage, improvements of the capacity of private enterprises should be addressed

- Support for the conception and implementation of appropriate industrial strategies (improvements of governmental organization's capacity)

In Mozambique, principal and effective industrial strategies, like the establishment of Industrial Free Zone (IFZ) at adjacent areas of the principal harbours, increase of productivity and diversification of products in agricultural sector through the investments by foreign capitals (e.g. by Zimbabwe), advancement of food-processing industry, infrastructure development through the implementation of "corridor plan" and so one, are clearly established. The problem is how to realize these strategies while utilizing foreign capitals, and improvement of the capacity of government sector like private sector is necessary to achieve it. Thus, capacity building of relevant government organisations, especially to the trade and investment promotion bodies, through technical assistance and provision of information are necessary.

9.2.8 Cross-border assistances (SADC assistance)

(1) Issues for Private Sector Development

The issues faced by SADC from the policies and institutions perspectives are how should/can each country implement the trade protocol formulated in the Directorate of Trade, Industry, Finance and

Investment Programs (SADC-TIFI), and the finance and budget protocol currently partially been formulated. In particular, regarding the former, the issues are the reduction of tariff and non-tariff barriers (NTB), appropriate operations vis-à-vis the regulation on certificates of origin and the implementation of WTO agreements, etc. As regards to the latter, it concerns the harmonisation of macroeconomy and monetary policies, liberalisation of the financial sector, improvements in SME finance, alignment of similar competing investment legal framework, and the effective promotion of FDI, etc.

On the other hand, between Japan and SADC countries, there is a problem that even though the countries enjoy some level of trade relations, excluding South Africa and some resource abundant countries, the level of investment from Japan are very small. This issue should be examined through framework of investment climate improvements at the individual country level. This issue should also be examined at the same time through the framework of cross-border infrastructure development and information sharing. This means that it should be examined with from the standpoint of questioning how it is possible to promote more active entries by Japanese enterprises for the whole of SADC's business chance.

(2) Practical Assistance Measures

1) Priority issues

- Increased and extended support of feasibility study of infrastructure

Improvement of wide-area cross border project needs a feasibility study of a bigger size than ever. Funds for such feasibility study shall be provided in a correspondingly increased amount to promote participation by private business. On the other hand, partial improvement of investment climate that contributes directly to investment inducement, such as the export processing zone, would only require small scale investment, for example a large, full scale electricity generating facility will not be required. In such a case, feasibility study may be extended to include, for example, generators utilizing renewable energy

- Support of business information exchange between SADC and Japan

This is to promoted business information exchange between SADC and Japan which does not exist in any concrete manner at present. For this purpose, it is recommended to establish a "Japan Desk" at the Department of Industry of South Africa (DTI) which has abundant information on the SADC market service, match-making, organising trade and investment delegation, etc. It will also play a role of the liaison officer to Japanese private investors in alliance with Association of Southern African Chambers of Commerce and Industry, in order to promote information exchange and business interaction at the private sector level.

2) Issues to be addressed in the medium- to long- term

- Assistance for SADC's Program for Trade, Industry, Finance and Investment (SADC-TIFI) (Capacity building of SADC Secretariat)

This is to delegate experts of various fields to SADC to support implementation of trade protocol, development policy of local industries, financial and fiscal protocol of member countries. Experts based in SADC Secretariat will go on a regionwide tour to confirm implementation status of such protocols and policies and give advice to the governments concerned in respect of problem areas. They will report findings to the Secretariat and feed them back to other member countries, thereby encouraging mutual cooperation for implementation of among the member countries.

- Support to the college affiliated to the South African central bank

In South Africa's central bank, Reserve Bank of South Africa, there is a "college" aimed for central bankers in the SADC region, and this college is providing capacity building assistances. Dispatch experts or conduct consulting type development research assistance to this college. If necessary, this assistance may be extended to direct assistances to each country's central bank within SADC.

The following are thought to be issues that merit assistance in all SADC countries:

1. Increased role of the central bank to provide funds to the private sector
2. Improvement on the quality of central banker regarding the supervisory and training role it has towards commercial banks in order to provide appropriate loans
3. Capacity building towards private sector (especially SME) loan promotion – screening of loan application, risk management capacity improvement
4. Establishment of enterprises information center (Credit Bureau)
5. Establishment of guarantee facilities

- Assistance for fledging bond market to grow

Nine countries including South Africa have stock markets in SADC areas. These markets are now of a small size, but developing progressively. On the other hand, bond markets (where short or medium- and long-term CP's and bonds are traded) are very limited. It is effective for diversification of methods of fund raising to extend the range of issuers from governments and public authorities, etc. to private businesses. Further needs study is necessary in respect of respective countries, but the development of bond market is a task to be addressed in the framework of intra-SADC cooperation with assistance of the Johannesburg Stock Exchange and others.

- Streamlining of local government procurement regime and better management of projects

Economic and social infrastructure is so undeveloped that it may be improved also by direct investment. Support of streamlining and standardizing of local government procurement regime as well as support of human resources development for better management of projects is very effective for promotion of investment for infrastructure. Experiences in intraregional semi-advanced countries including Tanzania may be disseminated to other countries as a method of training corresponding to their development stage.

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