African Economic Outlook

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The African Development Bank Group is a regional multilateral development finance institution the members of which are all of the 53 countries in Africa and 25 countries from Asia, the Middle East, Europe, North and South America. The purpose of the Bank is to further the economic development and social progress of African countries, individually and collectively. To this end, the Bank promotes the investment of public and private capital for development, primarily by providing loans and grants for projects and programs that contribute to poverty reduction and broad-based sustainable development in Africa.

The non-concessional operations of the Bank are financed from its ordinary capital resources. In addition, the Bank's soft window affiliates – the African Development Fund and the Nigeria Trust Fund – provide concessional financing to low-income countries that are not able to sustain loans on market terms.

By the end of 2004, the African Development Bank Group cumulatively approved 2 898 loans and grants for commitments of close to $50 billion. The commitments were made to 52 regional member countries and institutions to support development projects and programmes in agriculture, transport, public utilities, industry, education and health sectors. Since the mid-1980s, a significant share of commitments has also gone to promoting economic reforms and adjustment programmes that help to accelerate socio-economic development. About 60 per cent of total Bank Group commitments were financed on non-concessional terms, while the balance benefited from concessional financing.

Foreword

The *African Economic Outlook* project is a joint initiative of the African Development Bank and the OECD Development Centre. The Report was essentially drafted by a core team drawn from both institutions, supported by resource people in selected countries.

A generous grant from the Commission of the European Communities was essential to initiating and sustaining the project.

African Economic Outlook

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The comparative synthesis of the Report was drafted by Pierre Ewenczyk and Céline Kauffmann with inputs from: Bernhard Gunter, Barfour Osei, Nicolas Pinaud, Christine Rosellini, Mohammed Salisu, Audrey Verdier-Chouchane, and Lucia Wegner. Valuable inputs have also been provided by Jennifer Davies and Federica Marzo.

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The Outlook was prepared under the overall guidance of Ulrich Hiemenz, Head of Research, OECD Development Centre and Henock Kifle, Director, ADB Development Research Department.

Preface

With this fourth edition of our joint *African Economic Outlook* (AEO), we are delighted that the growing importance of the publication and its already substantial credibility are being confirmed. Much expanded from the original 22 countries studied in previous years to 29, the AEO 2005 provides an even broader overview of African economies. With the addition of Angola, Benin, Chad, Congo, Democratic Republic of the Congo, Madagascar, Niger, and Rwanda, both the depth and breadth of the coverage have been enhanced.

Including more countries has not only broadened the analysis of the African economy, it has also enabled us to provide more comprehensive information to governments and civil society in Africa, as well as to the business world and academia. We are proud that the AEO team, consisting of staff from both institutions and experts in the field, has managed to apply its standard methodology and rigour to all the countries, including the new ones. We regret that, unlike in previous editions, we have not been able to include Zimbabwe this year due to difficulties with data collection. We nonetheless expect the coverage to continue to widen in 2006.

The AEO has chosen to place the financing of small and medium-sized enterprises (SMEs) under its spotlight this year. Though recognised as being central to growth and employment generation, their number in Africa is surprisingly few – the so-called "missing middle" between the informal sector and large-scale companies. The AEO investigates this phenomenon and finds that SMEs struggle under regulatory environments that stifle them and that established financial institutions are ill-suited to their needs. Changing this situation will require more supportive policies, and we make some proposals about which policies need to be considered.

One of the major findings of this year's AEO is that many countries have seen their economic performance improve markedly in 2004, as commodity prices picked up, aid levels rose, and macroeconomic management continued to improve. Prospects for much of Africa are also more favourable than they have been for many years. We are also encouraged by the increased focus of the international community on Africa's development challenges. In particular, we welcome the Report of the Commission for Africa, the UN Millennium Project Report led by Professor J. Sachs, as well as the plans of Prime Minster Blair to put African issues as the centrepiece of the Gleneagles G8 Summit.

Building on recent achievements and maintaining the momentum of recent years to enable African countries make progress towards the Millennium Development Goals will require concerted action by African countries and their development partners. African countries, in co-operation with the African Union, will need to consolidate their current efforts to maintain peace and stability across the continent. They will also need to deepen their reforms, particularly those relating to good governance, and to strengthen their private sectors. The international community, in turn, will need to scale up its support by providing substantially higher levels of assistance and more extensive debt relief and by removing trade barriers and trade-distorting agricultural subsidies. In this regard, we look forward to the UN Summit in September 2005 and the renewed commitment of the world community to achieving the MDGs.

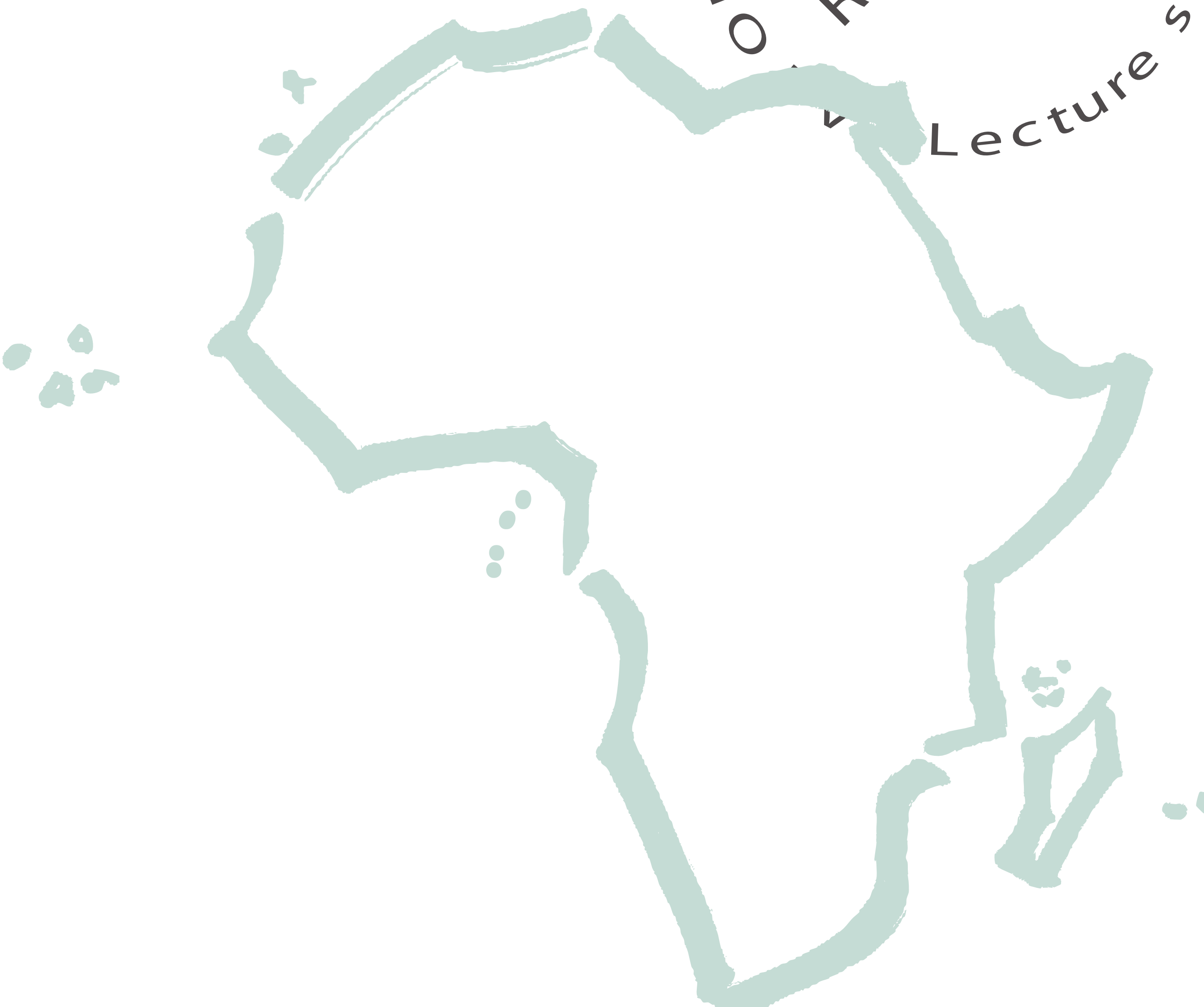
We are confident that, with these measures, African countries will continue to build on their recent achievements and make notable progress towards establishing transparent and accountable governance systems while at the same time improving the economic welfare of their citizens. The purpose of the *African Economic Outlook* is to contribute to the achievement of these goals.

Omar Kabbaj
President of the African Development Bank
Tunis

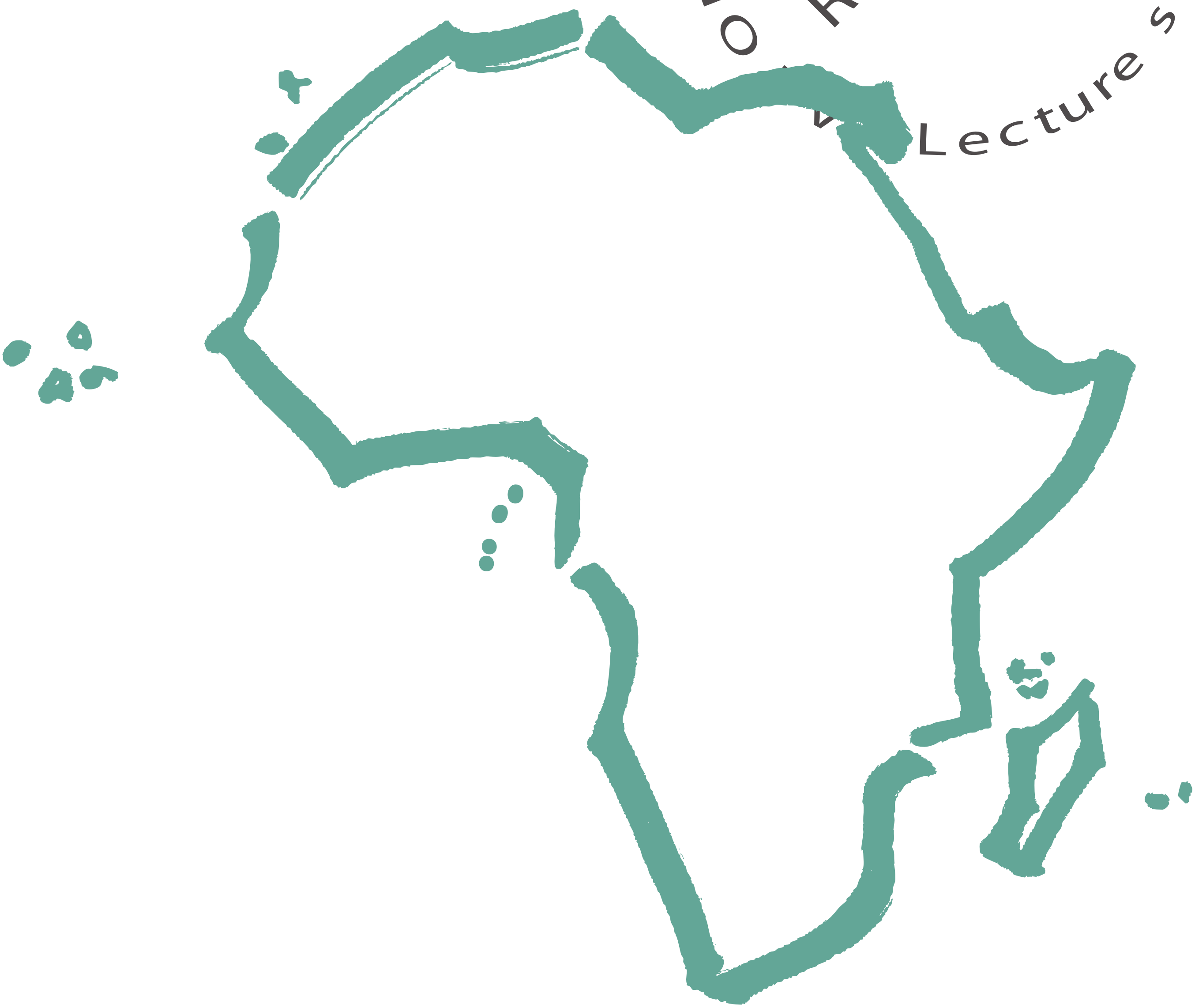
Louka Katseli
Director, OECD Development Centre
Paris

April 2004

Part One



Overview



This fourth edition of the *African Economic Outlook* assesses economic developments and prospects for the continent based on in-depth country studies. The coverage has been expanded from 22 countries in the third edition to the following 29 countries in the present one – these account for 85 per cent of Africa's population and 90 per cent of its economic output:

- In North Africa: Algeria, Egypt, Morocco and Tunisia.
- In West Africa: Benin, Burkina Faso, Côte d'Ivoire, Ghana, Mali, Niger, Nigeria and Senegal.
- In Central Africa: Cameroon, Chad, the Republic of Congo, the Democratic Republic of Congo, Gabon and Rwanda.
- In East Africa: Ethiopia, Kenya, Madagascar, Mauritius, Tanzania and Uganda.
- In Southern Africa: Angola, Botswana, Mozambique, South Africa and Zambia.

Our comparative assessment provides a continent-wide perspective, drawing on the country studies and supplementary analysis from the OECD Development Centre and the African Development Bank. Each year, the *Outlook* also provides an in-depth analysis of a topic critical for Africa's development prospects. In this year's edition, the focus is on financing small and medium-size enterprises (SMEs), following the focus on the issue of privatisation and the energy sector in the last two editions, respectively.

Economic activity in Africa is estimated to have risen by over 5 per cent in 2004, and while some countries continue to face serious problems – including the humanitarian catastrophe in the Darfur region of Sudan, the economic collapse in Zimbabwe, and conflicts in Côte d'Ivoire and some parts of the Democratic Republic of Congo – prospects for much of Africa are more favourable than they have been for many years. Underlying this pickup in growth are: the global expansion, notably through higher demand for commodities at higher prices; a significant increase in official development aid to Africa, driven largely by debt relief and emergency assistance, and improving macroeconomic stability. In addition, growth has been boosted by the coming on stream of new oil fields in Southern and Central Africa (Angola, Chad and Equatorial Guinea), a recovery of agricultural production following the drought that affected some Eastern, Central, and Southern African countries in 2003 (Ethiopia, Malawi and Rwanda), and some improvements in the security situation. The locust infestation that affected West and North African countries in 2004 has had a lower than initially expected impact, owing to the concerted efforts to fight the infestation.

Inflation has reached historical lows despite increasing oil prices. Trade balances have improved in many countries, with the largest gains for exporters of oil and metal ores, while some countries were adversely affected by higher import bills and lower prices for some agricultural products, cocoa and cotton in particular. The windfall gains from commodity prices have improved public finances, notably in oil-exporting countries. These gains will need to be managed carefully to avoid boom-bust cycles that can result from price volatility. In that respect, the *Outlook* highlights recent efforts by a number of oil-exporting countries to improve the transparency of their petroleum-sector operations and introduce fiscal rules for the use of oil revenue.

After a significant decline throughout much of the last decade, aid levels have increased in recent years and Africa is the continent that has benefited the most. The launch of NEPAD, the Monterrey consensus on financing for development in 2002, and the implementation of the Heavily Indebted Poor Country initiative – which eased external debt burdens – have all played an important role in making Africa the focus of development aid. Despite this encouraging trend – and the increasing growth in economic activity in

Africa, based on existing donors' commitments, aid is expected to fall well short of the amounts required to help most countries attain the Millennium Development Goals (MDGs) by 2015. In that respect, the progress report on the MDGs confirms the diagnosis of last year's AEO; on recent trends, only 6 African countries – most of them in North Africa – are likely to meet the key target of halving the share of the population living on less than one dollar a day.

In this regard, the year 2005 has seen the development of a series of new initiatives aiming at providing increased and more effective aid in the run up to 2015. The *Outlook* assesses these initiatives and reviews the significant framework agreements that have recently been reached in the Doha Round of multilateral trade talks. This holds the promise of reducing agricultural subsidies in developed countries and tearing down the trade barriers that hinder market access for African goods. Specifically, the framework agreements call for the elimination of export subsidies, in particular in the cotton sector, and the reduction of trade-distorting domestic support and substantial tariff reduction. A specific timetable for the implementation of these measures, however, has yet to be decided. Outside the Doha Round, the lifting of quota restrictions on trade in textiles and clothing from the beginning of 2005 is likely to pose a problem for textile-exporting countries in Africa (including North African countries, Mauritius and Madagascar), as they are vulnerable to competition from Asian countries, in particular China.

With the recognition of its critical role in economic growth and poverty alleviation, the focus on promoting good governance has intensified in recent years. The NEPAD has played an important role in this regard. In that context, the African Peer Review Mechanism launched recently is expected to provide a candid assessment of the situation in African countries and foster progress in this area. The *Outlook* highlights that democracy has started to take root in a number of countries in the last ten years, and, in parallel, conflicts have started subsiding. Corruption, however, continues to be prevalent in many countries. Further, despite progress in macroeconomic management and the regulatory environment, more needs to be done to ensure an environment conducive to private-sector development.

African SMEs have suffered from this still adverse business environment, which has resulted in a "missing middle" between very large firms – often multinationals – and the informal sector. This year's AEO sheds light on obstacles to their development, focusing on access to external finance. Drawing on the often disappointing experiences with SME promotion programmes in Africa and the AEO country studies, the *Outlook* stresses that to help SMEs emerge and grow to their efficient size will require sustained efforts. An approach that is many pronged is needed to improve access to finance. This would include a better investment climate, improved capacity to cope with banks' requirements, and more diverse sources of financing from financial institutions – including micro-finance – and the existing large enterprises.

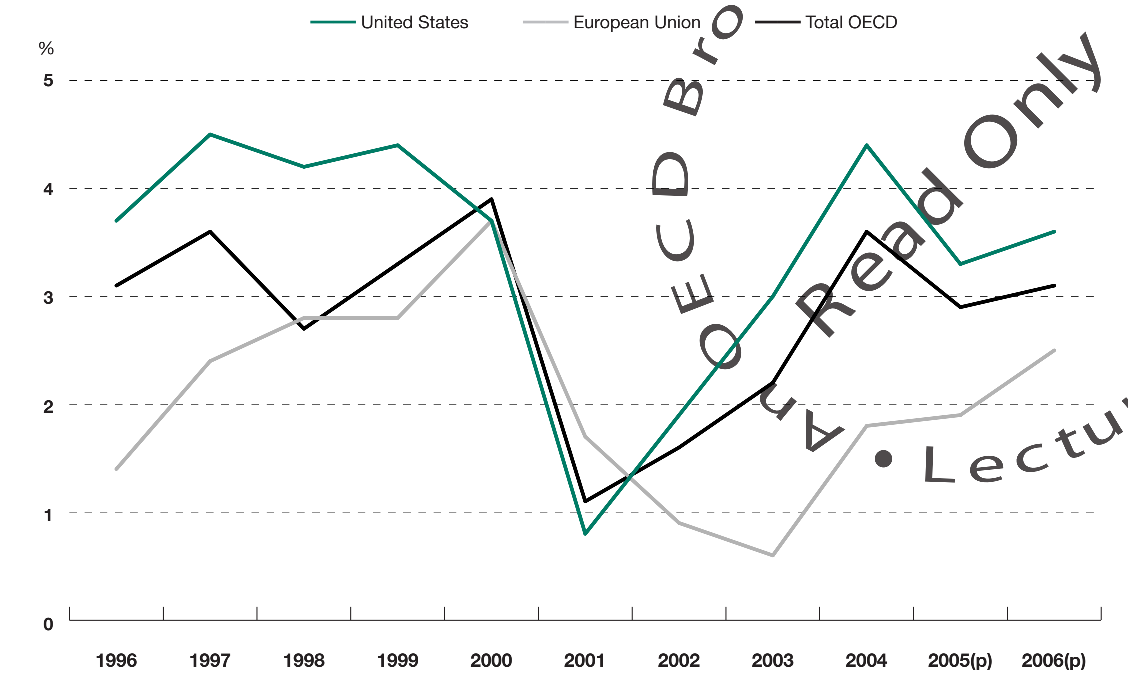
International Environment

Growth in the OECD Area

Following the sharp slowdown in 2001, economic recovery in the OECD area has become increasingly well established, with GDP growth increasing to 1.6 per cent in 2002, 2.2 per cent in 2003, and 3.6 per cent in 2004[1]. The expansion has continued to be led by the United States, while the upturn was also very strong in Japan and the expansion took root in the euro area. Economic growth has been underpinned by accommodative macroeconomic policies and favourable financial-market conditions (including low long-term interest rate). It has slowed, however, by end-2004, as the effects of the sharp increases in oil prices set in, and it is expected to hover around 3 per cent in the OECD area in 2005 and 2006, according to the OECD Secretariat (Figure 1).

1. Source: OECD (2004), *OECD Economic Outlook*, December.

Figure 1 - **Growth in OECD Countries**



Source: OECD.

The economic recovery in the OECD area has provided a large impetus to African economic activity. Overall, African export volume increased by 6.5 per cent per year in 2003-04 (against less than 1 per cent in 2001-02). Any trade-induced stimulus has to take into account the difference in growth between the European Union and the United States, as Africa sells about 50 per cent of its exports to the European Union, and only 15 per cent to the United States[2]. While the economic upturn in Europe lagged behind that in the United States in 2002-04, the stronger European growth expected in 2005 and 2006 will help sustain the demand for African goods by OECD countries in the two coming years.

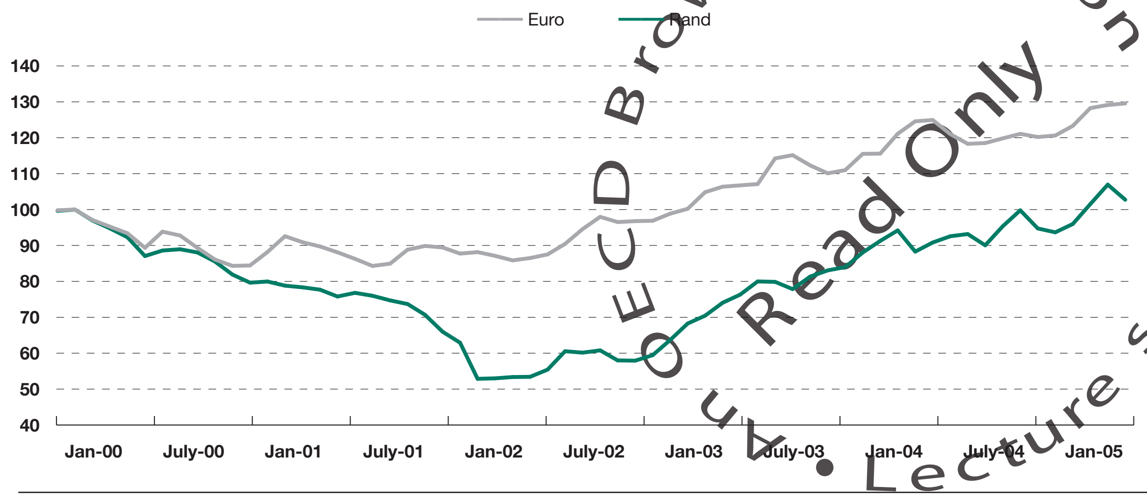
Exchange Rates

The US dollar has continued to depreciate strongly amid concerns over the sustainability of flows needed to finance the US current account deficit. Despite some reversal in early 2005, the US dollar has depreciated by some 45 per cent against the euro since end-2001, weakening European export growth (Figure 2). Changes against other currencies, however, have been more moderate; and, overall, exchange rate adjustments have remained orderly.

The depreciation of the US dollar, and the corresponding appreciation of the euro, has had an important impact on economic activity in many African countries. Overall, there was a large real effective exchange rate appreciation in African countries (exceeding 10 per cent cumulatively in 2003-04). The Franc Zone countries, whose currency is pegged to the euro, were strongly hit. Their external competitiveness deteriorated, stemming the expansion of non-traditional exports, while the CFA franc value of their traditional exports–mostly raw materials priced in dollars–was negatively affected. The South African rand also appreciated sharply, following its substantial depreciation during 2000-2001; the strengthening of the rand affected the Southern African countries whose currencies are pegged to it.

2. IMF, *Direction of Trade Statistics.*

Figure 2 - **Value of the Euro and the Rand against the Dollar** (base 100 in January 2000)



Source: www.x-rates.com.

Raw Materials Prices

Strong world demand and supply shortages were responsible for commodity prices rebounding sharply during the global recovery. In dollar terms, metals and minerals, and oil prices increased the most since 2001 (up almost 60 per cent). In domestic currency terms, however, the impact of these price hikes was dampened for many countries because of the depreciation of the dollar over the same period.

The general rise in global commodity prices has had a positive impact on the trade balances of many African countries, although higher oil prices have hurt oil importers. The countries with the largest gains have been mostly exporters of oil and metal ore. For most other countries, gains from higher-priced commodity exports have been roughly equivalent to losses from oil imports. However, a number of countries have faced net losses reflecting lower prices for some agricultural products – cocoa in 2003/04, cotton in 2004. The dependence of many countries on commodity market developments remains a key vulnerability over the medium term. In the immediate, careful management of the windfall gains from the increase in commodity prices is key to avoiding boom-bust cycles that can result from price volatility.

Oil

The rise in crude oil prices to record nominal highs has been accompanied by higher price volatility (Figure 3). This surge in prices, which was largely unanticipated, has reflected a number of factors, including: the level and growth in the global demand for oil as the global recovery has taken hold; the disappointing growth in oil production and the tensions in oil-exporting nations – particularly Iraq, Nigeria, Russia and Venezuela; the low levels of spare oil production capacity; and the low inventories of crude oil in the OECD countries. With excess capacity still very low, prices are likely to remain high, especially if the global expansion remains solid. Average crude oil price is expected to increase from $/barrel 37.8 in 2004 to $/barrel 44.7 and $/barrel 43.2 in 2005 and 2006, respectively. High oil prices have slowed but not derailed the global expansion; however, oil price uncertainty will continue to dominate the risks surrounding economic activity in the near term.[3]

Metals

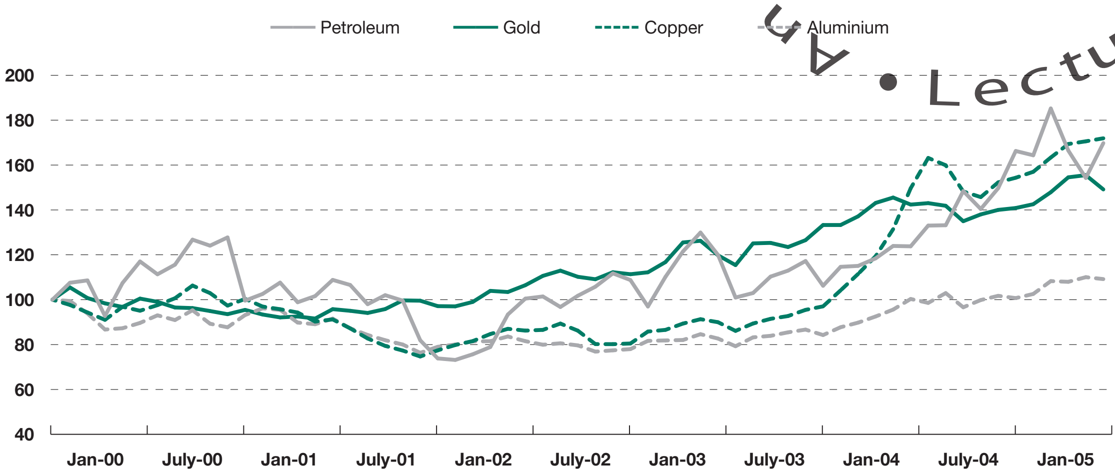
Metals prices continued to increase sharply by 16 per cent in 2004, in large part because of China's high demand for metals products. They are expected to

3. See: OECD (2004), *OECD Economic Outlook*, December.

remain strong in 2005 due to depleted inventories. The price of gold has escalated since mid-2001, triggered by the reduction of producer hedging – as interest rates lowered – and by international uncertainty; this benefited South Africa, the world's leading producer, and other African gold producers, such as Ghana and Mali – although the strength of the rand and the CFA franc dampened the impact of buoyant commodity prices in South Africa and Mali.

Prices of other metals also rose substantially in 2003 and 2004. Copper prices rose by 90 per cent during the twelve-month period to March 2004, as the market moved into deficit on strong demand and marginal growth in supply; since then, prices have been volatile. Gains in aluminium prices have been more modest over the last two years (33 per cent), because of the large expansion of primary aluminium capacity and exports in China. Zambia (for copper) and

Figure 3 - **Prices of Oil and Metals** (base 100 in January 2000)



Source: World Bank.

to a lesser extent Mozambique, Ghana, Cameroon and Guinea benefited from these increases.

Agricultural Products

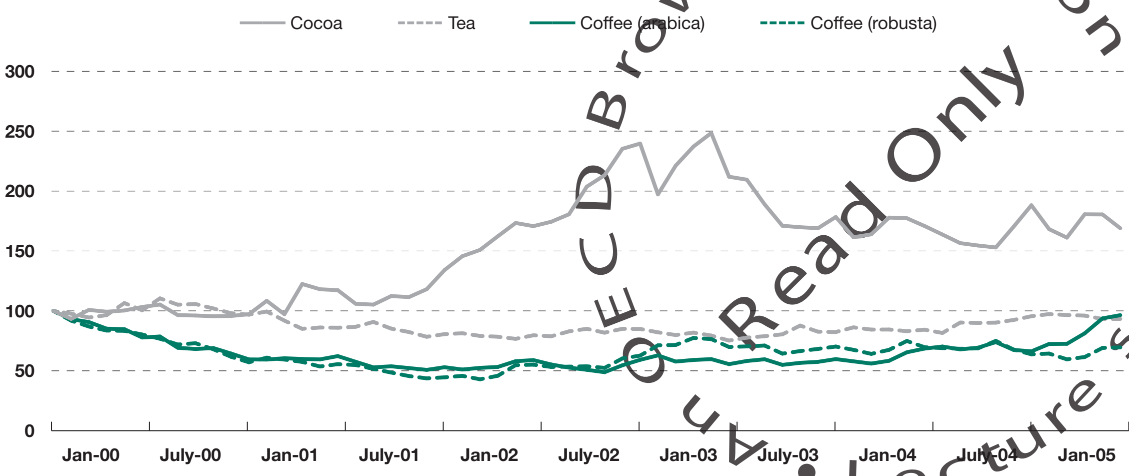
Prices of tropical commodities have been volatile and generally performed poorly (Figure 4). Cocoa prices reflected the uncertainties generated by the civil conflict in Côte d'Ivoire, the world's largest cocoa producer and exporter. Following record lows in the early 2000, prices recovered to reach new highs in early 2003, fell sharply during 2003 as a significant supply response took place, and have stabilised since then.

The prices of coffee, exported by many African countries, increased substantially in 2002; since then, they have held fairly steady (increased for the Arabica variety). However, they have not yet fully recovered their level of early 2000, and fundamentals for coffee remain weak, as consumption remains static and global stockpiles are abundant.

Tea prices have risen by nearly 25 per cent since March 2003, following a 33 per cent decline between September 2000 and early 2003. The outlook for tea prices, however, is less favourable, in view of the declining trend in consumption growth and the continued growth in output.

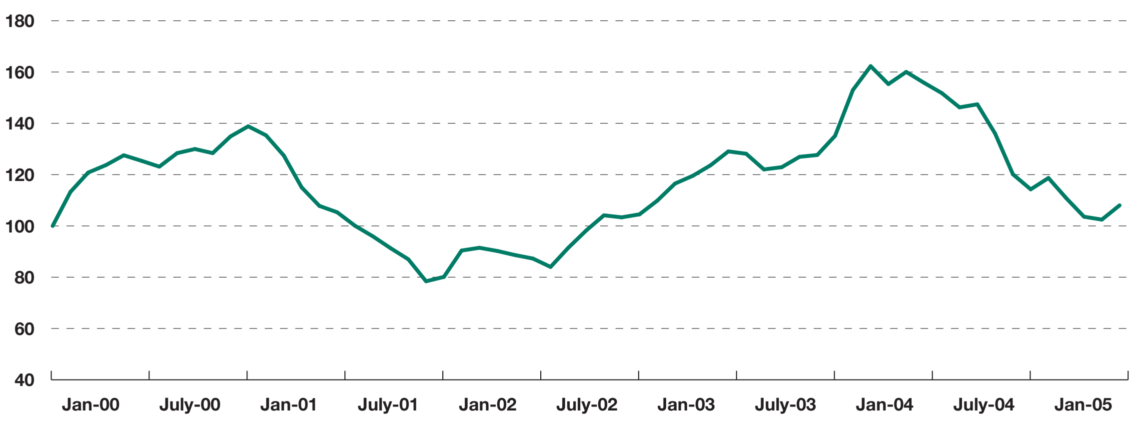
Cotton prices have fallen particularly sharply in the course of 2004 (Figure 5), following the recovery from their trough in October 2002. This drop will substantially lower export earnings in countries like Mali, Benin, and Burkina Faso in 2005. The cotton price illustrates the problems encountered by some of the poorest sub-Saharan countries in the context of trade distortions. West and Central African countries produce low-cost, high-grade cotton, but face unattractive world

Figure 4 - **Prices of Tropical Beverages** (base 100 in January 2000)



Source: World Bank.

Figure 5 - **Price of Cotton** (base 100 in January 2000)



Source: World Bank.

prices which have been dampened by the provision of substantial subsidies from developed countries in recent years. An additional burden for the cotton-producing countries in the CFA zone has been the appreciation of the euro against the US dollar since 2000.

The "cotton initiative" launched in September 2003 by four West African countries (Benin, Burkina Faso, Mali and Chad) to end cotton subsidies in WTO member countries was finally included in the WTO General Council decision reached in mid-2004 on the framework to proceed with agricultural negotiations (Box 1). However, no specific timetable for its implementation has been decided yet. In the meantime, there is a need to speed up the process of providing the necessary assistance to African producers until the removal of subsidies results in higher prices. In the present situation of low prices, distorted by subsidies, African production costs are above the world price, which threatens cotton production in countries where the sector is key – an estimated 12 million people are dependent on cotton for their livelihood in West Africa.

Official Development Assistance

Over the last three years, there has been a continued and significant rise in Official Development Assistance (ODA). According to the OECD's Development Assistance Committee (DAC), total ODA rose by 7 per cent in real terms in 2002 and by a further 5 per cent

Box 1 - **Africa and the Doha Development Agenda**

The Doha Development Agenda (DDA) – a round of trade talks launched in November 2001 – is aimed at fostering development by increasing developing countries' opportunities from further trade liberalisation, but it has suffered from missing deadlines and mounting frustrations. One of the stumbling blocks was the lack of progress on agricultural liberalisation. In fact, the 2002 US Farm Bill would have increased the level of support provided to US farmers, while in Europe, the 2003 reform of the EC's common agricultural policy (CAP), which shifted support from the "Blue Box" (production limiting) to the "Green Box" (perceived to be less trade distorting), has left the level of producer support virtually unchanged. Developing countries, at the Cancùn Ministerial in September 2003, were unwilling to move into a new round of trade negotiations, as they perceived that their long-standing issues were not addressed. As a result, the Cancun trade talks ended in failure.

The "July Framework": putting back the DDA on track?

From January-July 2004, however, constructive efforts led to the emergence of an agreed framework, dubbed the "July Package/Framework". The package, by itself, does not translate into tariff cuts or elimination of subsidies, but it sets out modalities for future negotiations in five key areas: agriculture, Non-Agricultural Market Access (NAMA), services, development issues and trade facilitation. Its most salient features regarding agriculture in general and cotton in particular, are the following:

Agriculture: The framework calls for "substantial overall tariff reductions", with highest tariffs subject to biggest cuts. Industrial countries are allowed to maintain a high level of tariff protection on so-called "sensitive products", subject to expanding the tariff-quota rates on these products and compensating for this with greater liberalisation for other products. The special and differential treatment (SDT) aspect of the framework would allow developing countries to make lesser tariff reductions, to designate "Special Products" and to apply a "Special Safeguard Mechanism" for food security and rural development purposes. The framework expresses a commitment to eliminate agricultural export subsidies – albeit without specifying a timetable – while allowing developing countries to maintain certain export subsidies to market and transport their products "for a reasonable time". The framework agreement also aims at substantially reducing trade-distorting subsidies to domestic production, including capping the "blue box" support. The framework suggests a cut of at least 20 per cent in the total level of domestic subsidies in the first year of implementation. Developing countries will not be required to cut certain domestic supports aimed at poor farmers and subsistence.

Cotton: The July framework reaffirms the importance of the sectoral initiative on cotton launched by four African countries – Benin, Burkina Faso, Chad and Mali. These countries complained that cotton subsidies depressed world prices and damaged their cotton industry. The July framework stipulates that the issue of cotton should be addressed "ambitiously, expeditiously and specifically" as part of the agriculture negotiations. The cotton negotiations would encompass all trade-distorting policies affecting the sector – from import tariffs, domestic support subsidies and export subsidisation. A new sub-committee on cotton, established in November 2004, has begun working to that effect.

in 2003. In 2003, aid volume reached $69 billion, its highest level ever in nominal and real terms. Yet the recent recovery in ODA is less impressive when measured as a share of DAC members' gross national income (GNI). The ODA/GNI ratio increased from 0.22 per cent in 2001 to 0.25 per cent in 2003, which remains short of previous averages (0.33 per cent achieved in 1980-92) and of the United Nations ODA target of 0.7 per cent[4].

Much of the increase was due to debt relief, including under the Heavily Indebted Poor Countries (HIPC) Initiative[5]. By end-2004, debt-reduction packages had been approved for 28 of the roughly 40 countries initially targeted for HIPC assistance, amounting to $54 billion in total[6]. The initiative is subject to a sunset clause imposing a deadline by which eligible countries would

4. OECD (2005), DAC, *2004 Development Co-operation Report*, Paris.

5. Net bilateral aid for debt relief was over $8 billion in 2003, from $5 billion in 2002.

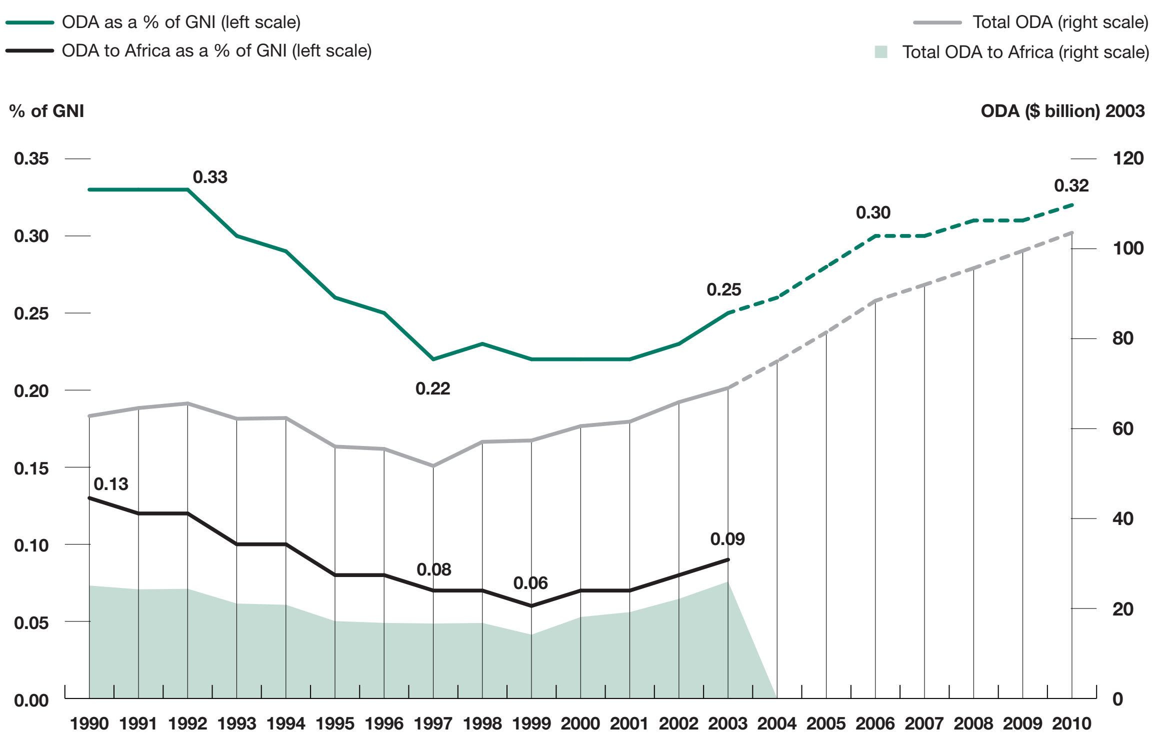
6. These 28 countries had reached the HIPC Initiative decision point – when the amount of assistance to be committed is decided, normally at the end of an initial three-year performance period; among these countries, 15 had reached the completion point – when the country receives the bulk of its assistance without further policy conditions.

need to adopt an IMF-supported programme that would qualify them for debt-reduction action. In September 2004, the sunset clause was extended — for the fourth time — to end-2006. This suggests there will be continued high levels of debt-forgiveness action by DAC members over the next two years, since more than half the total estimated costs of the HIPC initiative are accounted for by countries that had not yet reached their completion point.

Based on donors' commitments, further substantial growth in real ODA is expected until at least 2006, a key target date established at the Monterrey conference in March 2002 (Figure 6). Denmark, Luxembourg, the Netherlands, Norway and Sweden are the only OECD countries meeting the 0.7 per cent target. Four others have given firm dates to reach it – Ireland by 2007, Belgium and Finland by 2010 and France by 2012 with an interim target of 0.5 per cent by 2007. Spain has said it may reach 0.7 per cent by 2012 and the United Kingdom by 2013. Canada intends to double its ODA between 2000 and 2010, and Switzerland has committed to reach 0.4 per cent by 2010. If these commitments are met, ODA will reach $88 billion (at 2003 prices and exchange rates) or 0.30 per cent of DAC GNI by 2006, and $100 billion by 2010.

Despite this encouraging trend, the estimated figure for 2006 falls still well short of the amounts required to help countries attain the MDGs by 2015. The 2001 Zedillo Report, which established authoritative estimates for MDG financing requirements, projected an additional $50 billion more than 2003 ODA levels

Figure 6 - DAC Members' ODA: 1990-2003 and Simulations to 2006 and 2010, based on Commitments at Monterrey and Since



Source: OECD (2005), *ECA/OECD/DAC Mutual Review of Development Effectiveness*, Paris.

7. United Nations (2001), *Report of the High Level Panel on Financing for Development ("Zedillo Report")*, New York.

and a figure close to $120 billion in 2006[7].

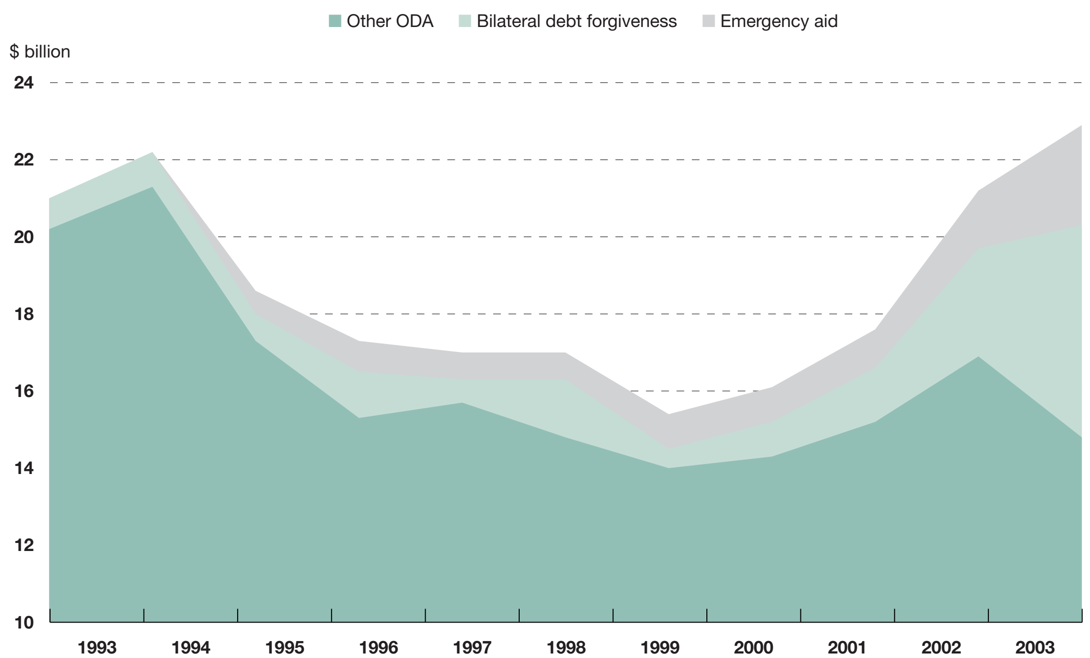
Growth of aid to Africa

Africa is the continent that benefited the most from the recent aid increase. Africa's share of total ODA, which had fallen to 36 per cent of the total by 1999, recovered to 46 per cent in 2003[8]. This rising financial resource flow for Africa was driven largely by debt relief and emergency assistance, which reached 19 per cent and 8 per cent of total ODA, respectively, in the last two years. In 2003, the out turn was largely determined by the debt relief for the Democratic Republic of Congo (about $4.5 billion). In parallel with a rise in grants for debt forgiveness, the share of ODA in the forms of loans and grants for programmes and projects has fallen (figure 7). As the increased amounts of debt relief and emergency assistance appear not to have been fully additional resources, there is concern that they might crowd out other forms of development aid.

Africa is the main ODA recipient region for 17 of the 22 DAC bilateral donors. Main bilateral donors to Africa are EU countries – in particular France – and the United States. Top multilateral donors are the European Commission, the World Bank and the African Development Bank. Annual aid in 2003 amounted to $31 per head in Africa, about two and a half times the aid per head received by the total developing world population. While aid per capita for Africa has increased since 2000, it has fallen substantially from its 1990 level, by about $15.

ODA flows to individual countries have varied enormously since 2000. For some countries aid has been cut by half, while it has largely increased for others. ODA to Zimbabwe and the Central African Republic has decreased considerably, reflecting mounting governance problems. Conversely, politically stable countries with more accountable governments have seen their ODA shares increase substantially. Excluding the sharp increase in debt relief to the

Figure 7 - **Net ODA to Africa 1993-2003**



Source: OECD (2005), *ECA/OECD/DAC Mutual Review of Development Effectiveness*, Paris.

8. Based on region allocable ODA only.

Democratic Republic of Congo, Ethiopia, Mozambique, Uganda and Tanzania accounted for 30 per cent of total ODA to the 50 countries in sub-Saharan Africa in 2003, while Egypt accounted for over 40 per cent of flows to North Africa.

The NEPAD process has proved to be instrumental in making Africa the focus of development assistance flows. Together with the HIPC initiatives, it also contributed to the shift in the sector allocation of ODA towards social sectors (mostly education and health) and governance activities. The Monterrey and subsequent Kananaskis announcements by the G8 countries pledged that 50 per cent of the total increase in ODA expected for 2006 should be devoted to African countries. Despite this encouraging trend, the MDGs remain underfinanced and most of Sub-Saharan Africa is far from making progress on most of the eight goals. Ten years from the targets, the assessment of the progress made so far and identification of priorities for MDG achievement have risen to the top of the international development policy agenda.

Aid prospects

The year 2005 has seen the development of a series of initiatives aimed at providing increased and more effective aid in the run up to 2015. A review of the progress on the MDGs has started, notably with the release of the Millennium Project's Report[9] in January 2005, and will culminate with the September 2005 UN Millennium Summit and the formulation of a world action plan. The UN Millennium Project advocates detailed MDG needs assessments on a country-by-country basis. Early simulations (based on Ghana) suggest that in a typical low-income country, external financing of public interventions will be required of the order of 10-20 per cent of GNP. Overall, the UN Millennium Project estimates that ODA required for the MDGs during the coming decade will be $135 billion in 2006, rising to $195 billion in 2015, equivalent to 0.44 and 0.54 per cent of donor GNP.

In tandem with UN efforts, the G8 summit in July 2005 will put Africa at the centre of its policy agenda. At the summit, significant actions are expected to be taken in terms of further debt relief, pro-poor trade liberalisation, and increased aid flows. These proposed actions have also been referred to as a "Marshall Plan for Africa". In order to base this Plan on a solid footing, the United Kingdom has set up a special Commission for Africa which has produced a report on "Action for a Strong and Prosperous Africa", focusing on the set of future actions required to "jump-start" development progress in Africa including governance and transparency, infrastructure, investment climate, and HIV/AIDS.

Against a background of donors' commitments still falling short of the funding required to achieve the MDGs, a variety of innovative approaches to mobilise resources have been recently examined (see Box 2).

Making aid more effective

In addition to the commitment by donors to increase ODA volumes, ambitious efforts by the international community and African governments are underway to improve the quality of aid. In the spirit of the 2002 Monterrey International Conference on Financing for Development, donors made specific pledges in the 2003 Joint Marrakech Memorandum on managing for development results and the 2005 Paris Declaration on Aid Effectiveness designed to reduce the transactions costs implicit in aid delivery, encourage more harmonised, joint efforts among bilateral and multilateral donors, and enhance aid effectiveness through results-based approaches.

Over the past two years, donors have started to

9. UN Millennium Project (2005), *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*, New York.

10. Reisen, H. (2004), *Innovative Approaches to Funding the Millennium Development Goals*, OECD Development Centre Policy Brief No. 24, Paris.

Box 2 - Mobilising Resources to Achieve the MDGs in Africa

Concerns over the feasibility of raising substantial and timely "traditional" aid in the run up to 2015 have led to a search for new ways of financing development. Recent initiatives focused on global taxes, more private-sector involvement, and various forms of financial engineering. The merits of these options should be judged against their revenue potential, whether they add or simply replace traditional sources, and their economic benefits and costs. [10] They must also be capable of securing political support and the earlier the better, given the tightness of the 2015 deadline.

Global taxes have widespread public support, notably among civil society groups, in part because they seek to finance a global public "good" (development) by imposing a tax on a global "bad", such as speculative international finance, pollution or the arms trade.

The ***Tobin Tax*** (a marginal levy on global currency transactions) would yield large returns; indeed, a rate of just 0.01 per cent applied on a global scale would generate an estimated $17-19 billion in revenue. The downsides are, however, the risk of a shrinking and very mobile tax base, difficulty in uniform application across jurisdictions, and possibly an increase in currency volatility.

As for taxing ***arms dealing***, even if the legal and documented trade in arms (worth around $50 billion per year) was unaffected by taxation, a 5 per cent tax would not yield more than $2.5 billion annually. Also, higher taxation could stimulate more illicit arms dealing.

Already today, ***"green" taxes*** yield on average 2.5 per cent of GDP in OECD countries. However, a global environmental tax seems too distant a prospect to help fund the MDGs in time. Nor are rich countries showing much sign of eagerness to pencil in proceeds from their new carbon-related tax for aid purposes. However, aeroplane kerosene enjoys a low or zero tax rate in EU member states and has been identified in early 2005 by France and Germany as one means of raising money to fund immunisation and anti-AIDS treatment in Africa.

A tax alone might not help meet the MDGs, so what about encouraging more private funding? Administered and financed by coalitions of governments, international organisations, private enterprise and civil society, ***topic-specific funds***, like the Global Fund to Fight AIDS, the Vaccine Fund and the Global Environment Facility, can serve as focal points for finance for specific urgent global problems. Nevertheless, they may result in a less coherent response to global problems, since they may duplicate existing structures or introduce new ones into what is already a cumbersome and complex management system.

What about engineering new financial instruments? The ***International Finance Facility*** **(IFF)**, suggested by the UK government, would stand a good chance of providing substantial additional funds for the MDGs in time. The IFF would be built on a series of pledges by donors (each lasting 15 years) for a flow of annual payments to the IFF. On the back of these pledges (its assets) the IFF would issue bonds in its own name (its liabilities). However, real liquid public assets would bolster the credibility of the Facility. The demand for bonds issues by the IFF might also be enhanced if they were equipped with a lottery ticket, modelled on similar low-risk schemes currently practiced in Bangladesh, Ireland and the United Kingdom.

The IFF could boost aid to as much as $100 billion per year during the crucial 2010-2015 period. In addition, since donor co-ordination would take place through existing aid delivery channels, poor countries would not have to face myriad donors and regulations. However, a broad international agreement about the IFF has not been reached as other donors are pursuing different strategies. The United States have favoured a bilateral approach. In March 2002, President Bush proposed increasing foreign aid by 50 per cent over the next three years by creating a Millennium Challenge Account (MCA). The MCA provides $5 billion per year to a select group of countries with "sound policies and honest governments".

simplify procedures and practices, to focus on delivery of development results, and to adopt common arrangements for sector wide approaches and budget support which allow for greater reliance on national systems and improved donor co-ordination. However, evidence from Mozambique, Tanzania and Uganda suggests that multi-donor budget support only bears fruit where there is sufficient mutual trust and accountability (Box 3).

Progress in implementing the consensus on greater aid effectiveness has been uneven. Projects are still the dominant mode of delivering aid, often channelled through donor-managed parallel structures, rather than being integrated into government priorities and budget

Box 3 - Mutual Accountability in Mozambique: the Donor "Performance Assessment Framework"

In all African multi-donor budget support arrangements, a framework for periodically assessing partner-country performance is defined and agreed. In an innovative twist, government and donors in Mozambique have agreed to establish a performance assessment framework for the donor community as well. The objective is to monitor donor behaviour regarding commitments, expose non-compliance and weaknesses to peer pressure and strengthen donor accountability to government. This arrangement includes the following key features:

- Donors will identify the indicators to be assessed, which subsequently will be discussed and vetted with government;
- Donor performance will be assessed by an independent assessment team and subject to periodic discussion by government and donor peers;
- The donor performance assessment framework will be linked to an action plan and timeframe for its implementation;
- Annual donor performance reports will be released into the public domain; and
- The framework will be continuously adapted on the basis of collective and individual donor performance assessments.

cycles. Moreover, the aid system, with its diverse monitoring and disbursement mechanisms, is still perceived as fragmented by many recipients. The result is lack of coherence and sustainability and further erosion of state capacity.[11] Finally, despite the apparent consensus that aid should be targeted to poverty reduction, historical ties and strategic interests continue to determine aid allocation, turning some recipients into "donor darlings" or "donor orphans".[12]

Increased aid effectiveness is also hampered by the unpredictability of aid flows, as only a minority of bilateral donors provide prospective aid commitments. Volatility in aid flows deeply compromises the ability of African governments to plan future public expenditures – and to undertake the strategic incremental investments required to meet long-term development objectives. More fragile countries suffer from higher volatility: whilst most recipients experience year-to-year ODA variations of 10 to 20 per cent, the figure can rise to 50 per cent or more for recipients suffering from conflict. The problem is most acute in vulnerable countries with low international reserves, where donors are unsure about government commitment and capacity to reform.

There has been a recent emphasis on the need for the harmonisation/alignment agenda to take into account recipient-country diversity, including their capacity to absorb aid, ability to raise internal or external resources, and special circumstances such as shocks or conflicts. This is of particular importance for many "fragile" African countries, where special emphasis on non-state actors might be desirable.

Macroeconomic Performances in Africa

Economic Growth

A favourable external economic environment, together with a relative improvement in domestic macroeconomic management, helped boost real GDP growth in Africa during 2004 to an eight-year high of 5.1 per cent in 2004. This performance allowed GDP per capita to rise by nearly 3 per cent. For the second year in a row, economic growth was particularly strong in oil-producing countries (5.8 per cent in 2003 and 6.1 per cent in 2004), which benefited from high world prices for oil and an increase in production capacity. Furthermore, despite the impact of higher oil prices, the

11. OECD (2005), "Mutual Review on Development Effectiveness: Improving the Quality of Aid: Issues and Challenges Ahead".

12. OECD (2005), OECD Development Centre / Overseas Development Institute informal workshop on "The International Aid System: What's Next?", Paris.

Table 1 - **Average Growth Rates of African Regions**

Region	1996-2002	2003	2004(e)	2005(p)	2006(p)
Central Africa	3.9	5.0	14.4	4.1	5.5
East Africa	4.1	2.3	6.8	5.2	5.1
North Africa	4.3	5.1	4.6	4.8	5.2
Southern Africa	3.1	2.6	4.0	4.6	5.2
West Africa	3.6	7.0	3.4	4.9	4.8
Total	**3.8**	**4.4**	**5.1**	**4.7**	**5.2**

Note: Owing to lack of data, these aggregates do not include Liberia and Somalia.
Source: Authors' estimates (e); projections (p).

non-oil producing countries also performed well, with growth in output reaching 4.4 per cent on average in 2004 (3.4 per cent in 2003). This trend of solid growth is projected to continue in 2005 and 2006 – although at a slightly lower rate of 4.7 per cent in 2005 as the coming on stream of new oil fields in Central Africa will be over – provided that global economy keeps expanding, regional conflicts continue to ease, weather conditions remain favourable, and policies facilitate the adjustment to the challenges posed by the changes in commodity prices (including the high prices for oil and the low cotton prices) and international trade arrangements (including the removal of textile quotas). In that respect, recent efforts by a number of oil-exporting countries to

Box 4 - **Improving Management of Oil Revenue during Periods of Price Booms**

With more than 100 billion barrels, Africa had 9 per cent of the world's oil reserves by the end of 2003. Half are located in North Africa. In sub-Saharan Africa, the oil-producing countries can be divided into three categories: the old ones where production is in decline (Congo, Cameroon and Gabon); those where production is still on the increase (Angola, Nigeria); and the new members of the club (Equatorial Guinea, Chad and Sao Tomé). However, most of these countries have suffered from the "oil curse" finding themselves heavily indebted and impoverished. For this reason, with the help of the international community, some oil-producing countries are seeking to take advantage of the high prices prevailing since 2003 to make better use of surplus revenue and to improve transparency in the oil sector.

1 – Regulations Concerning the Utilisation of Oil Revenue

Several countries have specific regulations for the use of oil revenue. In Nigeria and Congo, the budget is based on a very conservative estimate of the price of oil. Any surplus is then deposited in a special account with the central bank. In 2004, high oil prices enabled Nigeria to save a substantial amount of its oil revenue. The government of Congo used most of its 2004 budget surplus to make external debt repayments and regain the approval of the international community. In Algeria, the government's budget for 2005 calls for a significant reduction of the primary non-oil deficit in order to reduce the government's dependence on volatile oil income, thereby ending a pro-cyclical budgetary policy. Since 2001, priority has been given to investment, with adjustments being targeted at recurrent expenditure.

2 – Transparency of the Oil Sector

The Extractive Industries Transparency Initiative (EITI) aims to encourage information sharing between governments and private companies. Several African oil-producing countries (namely, Nigeria in November 2003, Angola in June 2003, Chad in October 2004, Gabon in May 2004, Congo and Sao Tomé and Principe in June 2004) have expressed their intention of adhering to the EITI in order to improve the transparency surrounding their oil income. Thus, Congo regularly publishes detailed information concerning financial transactions in the oil sector on its official web site, especially about its contracts with oil companies including the controversial financial dealings with a particular oil company in 2003. At the same time, the government has ended advance payment for the proceeds of future oil exports. In Chad, the allocation of oil revenue is regulated by law – 10 per cent is saved and the remainder is allocated to priority sectors – and the publication of an independent external audit carried out by the Petroleum Revenue Oversight and Control Committee is compulsory. Nigeria also publishes information on the government's oil income on a monthly basis.

improve the governance of their petroleum-sector operations are encouraging (Box 4).

North Africa

Following a pickup in economic activity in 2003 (5.1 per cent), real GDP growth in North African countries continued to be solid in 2004 (4.6 per cent), and this performance is expected to continue through 2006. In oil-producing Algeria, real growth moderated somewhat in 2004 to 5.4 per cent (from 6.9 per cent in 2003) due to a slower expansion of hydrocarbons output – a sector that benefited from the bringing on stream of new capacity in 2003 – and lower agriculture growth following the 2003 bumper crop. In the non-oil-exporting emerging-market economies of North Africa (Egypt, Morocco and Tunisia), economic performance continued to be solid in 2004. Growth was largely driven by the external sector in Egypt and Tunisia (including a rebound in tourism in the latter), reaching 4.3 per cent and 5.5 per cent, respectively. Growth slowed down in Morocco (to 3.5 per cent), following the high cereal production in 2003.

West Africa

Economic growth in the West African region slowed down considerably from 7 per cent in 2003 to 3.4 per cent in 2004. In the WAEMU (West African Economic and Monetary Union) area (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo), activity was affected by: the continued political turmoil in Côte d'Ivoire – the largest economy within WAEMU; the real appreciation of the CFA franc, which is pegged to the euro; a decline in agricultural output in Burkina Faso, Niger and Senegal; a poor cotton crop in Benin; and a decline in Mali's gold output; and the locust invasion, particularly in Guinea-Bissau, Mali, Niger and Senegal – although its impact was limited by concerted efforts to treat infested lands. Within the five non-WAEMU members of ECOWAS (Economic Community of West African States),[13] Nigeria recorded modest real GDP growth of 3.7 per cent in 2004, as oil production lowered during the second half of the year, reflecting capacity constraints and the impact of labour strikes; while Ghana and Sierra Leone saw robust growth in both 2003 and 2004 (averaging 5.5 per cent and 8 per cent, respectively) as a result of buoyant export demand. Prospects are for more robust growth rates in 2005 and 2006, but there are downside risks relating to the possible continuation of the lingering conflict in Côte d'Ivoire, oil prices (affecting in particular Nigeria's growth prospects), and the impact of the decline in the world price of cotton (on Benin, Burkina Faso, Mali and Togo).

Central Africa

Oil-rich Central Africa witnessed the most robust economic performance among the African regions, with an average real GDP growth estimated at 14.4 per cent in 2004. The strong economic growth in Central Africa was driven by the coming on stream of new oil production (in Chad, Equatorial Guinea and Congo) and increasing oil prices. The continued recovery in the post-conflict Democratic Republic of Congo, following its political stabilisation, also contributed to the increase in regional growth. Cameroon enjoyed continuing robust non-oil sector growth, and the Rwandan economy began to recover in 2004. In contrast, Gabon suffered from the declining trend in its oil production and a weak non-oil-sector growth, while the Central African Republic continued to be adversely affected by political conflicts. In 2005 and 2006, economic growth in Central Africa is expected to decline to trend levels.

East Africa

In 2004, average real GDP growth in East Africa increased markedly to 6.8 per cent, as Ethiopia grew by more than 10 per cent, reflecting improved harvests following crop failures in 2003 (which had caused activity to decline by 4 per cent in 2003). Tanzania and Uganda continued to perform well with real GDP growing by 7.4 per cent and 5.9 per cent, respectively. In Madagascar, which was hit by two major cyclones and a 50 per cent depreciation of the currency in early 2004, efforts to restore macroeconomic stability during the second half of 2004 proved successful and growth

13. Nigeria, Ghana, Sierra Leone, Guinea and Gambia.

is estimated to have reached 5.3 per cent. In Mauritius, activity rebounded in 2003 and 2004 to over 4 per cent, reflecting a recovery in tourism and sugar production. A moderate rebound in Kenya's growth started in 2004 (3.1 per cent). Activity in East Africa is expected to remain strong in 2005 and 2006. However, some countries in the region, notably Mauritius and Madagascar, face immediate challenges in light of the expected increased competition from China in the textile sector because of the end of the Multi-Fibre Accord.

Southern Africa

Economic growth also increased in Southern Africa, from 2.6 per cent in 2003 to 4 per cent in 2004, reflecting improved economic performance in Angola and South Africa, and this trend is expected to continue through 2006. In Angola, strong economic activity in 2004 (10.9 per cent growth) was supported by rising oil production from new fields. In South Africa, output picked up from 2.8 per cent in 2003 to 3.8 per cent in 2004, despite the continued strengthening of the Rand. Growth remained strong in Mozambique, Zambia, and Botswana (at 7.8 per cent, 5.1 per cent, and 4.4 per cent, respectively). In contrast, Zimbabwe's economy continued to contract.

Inflation

Inflation in Africa reached historical lows in 2004, as most countries made further progress in reducing inflation, despite increasing oil prices. Low world-wide inflation benefited countries with pegged exchange rates, such as CFA franc countries, while prudent monetary policy played a key role in an increasing number of floating-rate countries. Generally favourable weather conditions also contributed to reducing inflationary pressures. Only Zimbabwe, Angola and Eritrea recorded inflation rates above 20 per cent. The declining trend in inflation is expected to continue in 2005 and 2006.

Table 2 - **Weighted Mean CPI Inflation of African Regions**

Region	1996-2002	2003	2004(e)	2005(p)	2006(p)
Central Africa	31.1	3.5	2.4	3.9	3.5
East Africa	5.8	6.8	8.2	5.7	4.5
North Africa	3.3	2.5	4.5	4.7	4.1
Southern Africa	17.2	15.7	11.2	10.2	9.1
West Africa	9.7	11.2	9.9	9.7	6.5
Total	**11.0**	**8.3**	**7.9**	**7.5**	**6.2**

Note: Owing to lack of data, these aggregates do not include Liberia and Somalia.
Source: Authors' estimates (e); projections (p).

North Africa

Inflation continued to be low in North Africa in 2004, averaging 4.5 per cent. However, inflationary pressures gained momentum in Egypt in 2003/04 (8.1 per cent), due to the large exchange rate depreciation in 2003 and an expansionary monetary policy in the second half of the year. The pressure on prices that started in late 2003 in Algeria in the context of loose fiscal policy abated in the second half of 2004, as monetary policy became less accommodative. The slight increase in inflation in Tunisia was mostly due to adjustments in administered prices and supply-driven increases in certain food items, but the monetary policy stance remained prudent.

West Africa

In the WAEMU area, the CFA franc peg to the euro helped contain inflation to 1 per cent in 2004, but inflation remained higher and more variable in the West African Monetary Zone (WAMZ)[14]. Consequently, the targeted July 2005 launch date for a new common currency shared by the five countries of WAMZ is

14. Nigeria, Ghana, Sierra Leone, Guinea and Gambia.

expected to be missed. Inflation rates moderated significantly in Ghana and Nigeria, reflecting prudent macroeconomic policies, but all WAMZ countries continued to experience double-digit inflation, with an average approaching 14 per cent in 2004. Further progress in macroeconomic stabilisation in WAMZ countries is expected to ease inflationary pressures in 2005 and 2006.

Central Africa

Central Africa had the lowest inflation rate (2.4 per cent) across sub-regions in 2004. Inflation fell to low levels in most CEMAC (Communauté Économique et Monétaire de l'Afrique Centrale) member countries[15], whose common currency, the CFA franc, is pegged to the euro. Only Equatorial Guinea exceeded the convergence objective of 3 per cent annual inflation by a wide margin, as sustained double-digit economic growth continued to put pressure on domestic prices. On average, inflation in the CEMAC area was reduced to about 1 per cent. Outside the CEMAC, inflation continued abating in the Democratic Republic of the Congo to below 10 per cent in 2004 (from 357 per cent in 2001), despite slippages in the third quarter. In contrast, inflation increased to 11 per cent in Rwanda in 2004, where harvests were below expectations. Inflation is expected to remain low in the region through 2006.

East Africa

The dramatic increase in inflation in Madagascar was responsible for the average increase in the region to 8.2 per cent in 2004. In Madagascar, inflation surged (from -2 per cent in 2003 to 14 per cent in 2004), following the cyclones that hit the island in early 2004 and the rise in the price of rice – the country's main staple commodity. Excluding rice and petroleum products, however, inflation in Madagascar has remained fairly stable since mid-2004, and it is expected to decline to below 6 per cent in 2005 and 2006. Inflation also rose in Kenya, starting in 2003, as a result of an easing in monetary policy and, on the supply side, a poor harvest, but the tightening of monetary policy, starting in September 2004, is expected to reduce inflation in 2005 and 2006. The recovery in agricultural production in Ethiopia in 2003/04, following a serious drought in 2002/03, resulted in a decline in inflation to 9.1 per cent in 2004, which is expected to continue in 2005 and 2006. Inflation remained stable, at over 20 per cent in Eritrea, and hovering around 5 per cent in Mauritius, Tanzania and Uganda. Overall, inflation is expected to decline to trend levels in 2005 and 2006.

Southern Africa

Despite a continuous decline over the last two years, the average inflation rate in Southern Africa remained, at 11.2 per cent, the highest across the regions of Africa in 2004. However, this average masks a great diversity of out turns. Zimbabwe continued to record the highest inflation rate in Africa (282 per cent). In Angola, which had also experienced three-digit inflation rates throughout its 27-year civil war, inflation fell following the introduction of economic measures in September 2003, but progress towards stabilisation remained fragile, and the country still recorded the second highest inflation rate among African countries in Africa in 2004 (41 per cent). Although on a decreasing trend, inflation remained high in Zambia and Mozambique (at 18 per cent and 13 per cent, respectively), reflecting in part the effect of the depreciation of their currencies against the South African rand. In turn, the appreciation of the rand contributed to bring down inflation in South Africa, from 9.3 per cent in 2002 to 4.3 per cent in 2004, well within the central bank target range of 3-6 per cent.

Public Finances

The region's average fiscal balance (including grants) improved further in 2004, owing largely to the windfall revenues from high oil prices in oil-producing countries, which outweighed the larger deficits in some other countries. The fiscal surplus of oil producers increased from 0.4 per cent in 2003 to a record 2.4 per cent in 2004, while the average deficit in non-oil producers increased only slightly from 2.6 per cent of GDP in 2003

15. The CEMAC comprises Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea and Gabon.

Table 3 - **Average Budget Balance to GDP Ratio**

Region	1996-2002	2003	2004(e)	2005(p)	2006(p)
Central Africa	-1.1	2.4	3.9	6.7	6.8
East Africa	-3.4	-3.9	-3.0	-3.9	-4.0
North Africa	-0.9	-0.2	0.9	2.3	1.8
Southern Africa	-3.3	-2.8	-3.2	-3.0	-2.9
West Africa	-1.9	-2.0	3.7	3.0	2.4
Total	**-1.9**	**-1.4**	**0.0**	**0.7**	**0.3**

Note: Owing to lack of data, these aggregates do not include Liberia and Somalia.
Source: Authors' estimates (e); projections (p).

to 3 per cent of GDP in 2004. A further rise in the surplus of oil producers is expected in 2005.

North Africa

The average fiscal balance in North Africa improved by about 1 per cent of GDP in 2004, as the oil-exporting countries in the region recorded exceptional surpluses, and a further improvement is projected for 2005. Among the other countries, the fiscal situation improved markedly in Tunisia (with a deficit narrowing from 3.2 per cent of GDP in 2003 to 1.5 per cent in 2004), and remained stable in the other countries.

West Africa

The average fiscal balance in West Africa swung sharply into surplus in 2004 (improving by 5.7 per cent of GDP), mostly reflecting the large turnaround in oil-producing Nigeria, the largest economy in the region. The oil-price boom yielded significant windfall revenues in Nigeria, which, coupled with fiscal restraint-led to an estimated surplus of 7.4 per cent in 2004, from a fiscal deficit of 1.4 per cent in 2003. In contrast, fiscal deficits widened in the WAEMU countries in 2004, as the increase in oil prices and the locust invasion imposed an additional fiscal burden. Furthermore, government revenue in Benin and Niger suffered from the tightening of import restrictions by Nigeria. Elsewhere in the WAMZ, Ghana brought down its deficit further in 2004, following a sharp improvement in 2002 and 2003 (over the last 3 years, the deficit declined from 7.7 per cent of GDP to 2.7 per cent).

Central Africa

Fiscal positions improved on average in Central Africa in 2004, but there were significant differences between countries. In the oil-rich CEMAC member countries, fiscal consolidation was helped by rising oil outputs, higher oil prices, and a generally modest increase in spending. In contrast, the Democratic Republic of Congo experienced widening deficit over the last three years (from 1.7 per cent in 2001 to 4.8 per cent in 2004).

East Africa

Despite a marginal improvement in the last two years, the average fiscal deficit in East Africa remained relatively large (3.9 per cent of GDP in 2003 and 3 per cent of GDP in 2004). Official grants provided substantial and rising support for government budgets in countries that had passed the completion point under the HIPC initiative (Ethiopia, Tanzania, and Uganda) or received assistance after a conflict (Madagascar). These high levels of external support (ranging from 7 per cent of GDP in Tanzania to 10 per cent of GDP in Uganda in 2004) allowed spending to expand and be increasingly directed towards the alleviation of poverty or relief operations. In contrast, in Kenya low disbursement of donor support (with grants at 1.5 per cent of GDP in 2004) did not permit an increase in government outlays as expected.

Southern Africa

The limited rise of South Africa's fiscal deficit accounted for most of the increased regional deficit. South Africa kept fiscal deficits at low levels during many years in the framework of its successful macroeconomic stabilisation policy, providing room for more ambitious fiscal expansion, starting in 2003. Fiscal deficits increased from 1.5 per cent of GDP in 2002 to 2.4 per cent in 2003 and 3.2 per cent of GDP in 2004) as social spending was raised. Higher oil prices in Angola, and a substantial fiscal adjustment effort in Zambia, entailed lower fiscal deficits in those countries in 2004 (from 7.8 per cent of GDP to 3.4 per cent in Angola, and from 6 per cent of GDP to 3.9 per cent in Zambia). In Mozambique, which passed the completion point under the HIPC initiative and relies heavily on donor support (with grants at 8 per cent of GDP in 2004), the authorities offset a revenue shortfall in 2004 by lowering spending, including in some priority sectors.

Balance of Payments

The average external trade surplus continued to increase dramatically in 2004, as Africa's terms of trade improved (by 6.7 per cent), owing mostly to the rise in the prices of oil, and a further improvement in the trade balance for Africa is expected in 2005, based on continued high world prices for oil. The trade balance improved in all the oil producers in 2004 (increasing from 7.2 per cent of GDP in 2003 to a record 12.6 per cent of GDP in 2004 on average), while the trade deficits expanded only marginally among oil importers (from 2 per cent of GDP in 2003 to 2.7 per cent of GDP in 2004 on average). In the latter countries, diversification efforts and improving market access under trade agreements in selected sectors helped boost exports, but the stronger export volumes were more than offset by the slightly weaker terms of trade (2.8 per cent) and higher imports.

In the last few years, large inflows of capital were attracted by the oil-producing countries (Algeria, Angola, Chad, Equatorial Guinea, Nigeria and Sudan),

Table 4 - **Average Ratio of Trade Balance to GDP**

Region	1996-2002	2003	2004(e)	2005(p)	2006(p)
Central Africa	11.1	11.8	19.7	24.6	22.2
East Africa	-10.4	-10.5	-12.2	-13.4	-13.5
North Africa	-3.0	1.2	3.5	3.9	3.1
Southern Africa	3.4	3.1	3.7	5.0	5.9
West Africa	9.3	9.2	14.1	15.9	14.0
Total	**1.6**	**2.8**	**5.7**	**7.1**	**6.5**

Note: Owing to lack of data, these aggregates do not include Liberia and Somalia.
Source: Authors' estimates (e); projections (p).

as well as by Morocco (related to privatisations) and South Africa (Annex Table 10).

External debt burdens continued to fall as more countries reached the HIPC completion point and reliance on debt-creating flows declined. At end-2004, 12 countries had reached their completion point (Benin, Burkina Faso, Mali, Mauritania, Mozambique, Tanzania and Uganda by end-2003, and Senegal, Niger, Ethiopia, Ghana and Madagascar during 2004), while eleven others had reached their decision point and were already getting interim debt relief. Total debt is estimated to have declined, from 55 per cent of GDP in 2002, to 48 per cent in 2003 and 43 per cent in 2004.

There was a large real exchange rate appreciation in African countries over the last two years (exceeding 10 per cent), reflecting the sharp appreciation of the euro and the rand against the dollar. While it helped contain inflation, notably in South Africa and neighbouring countries, it eroded previous competitive gains – from the South African rand depreciation in 2001-02 and the 1994 devaluation of the CFA franc.

North Africa

The overall improvement in the external position of North Africa reflected the growing surpluses of the petroleum exporters, Algeria and Libya, which exceeded 15 per cent of GDP in 2003 and 20 per cent in 2004, while the large trade deficit in the other countries – ranging from 8 to 10 per cent of GDP – widened slightly on average in 2004. In Morocco, the deficit increased by about 1 per cent of GDP because of growing imports – related to higher wheat and oil prices, and capital goods imports – and low export growth, but workers' remittances and improved tourism receipts continued to sustain its current account. The trade deficit also increased by more than 1 per cent of GDP in Egypt, as the strong growth in exports was more than offset by higher imports relating to the economic recovery. In Tunisia, the external position remained stable, on the strength of non-energy exports and the recovery in tourism.

West Africa

The sizeable increase in the trade surplus of West Africa primarily reflected Nigeria's rising oil exports. Furthermore, Nigeria's policy of saving a large part of the windfall oil revenues helped contain its imports. In the WAEMU region, exports fell as a share of GDP by 1.5 per cent, mainly because of a decline in Côte d'Ivoire's cocoa exports and Benin's cotton exports, resulting in a deterioration of the trade balance for the WAEMU region. Elsewhere, Ghana also registered a deteriorating trade balance.

Central Africa

The trade balance improved strongly (by close to 8 per cent of GDP in 2004) in the oil rich CEMAC region, where exports continued their upward trend thanks to higher oil output and prices; only the Central African Republic, an oil importer, saw its trade account deteriorate due to its overall weak economic condition. Elsewhere, in Rwanda and the Democratic Republic of Congo, trade balances also deteriorated, although marginally.

East Africa

The average trade deficit widened by about 2 per cent of GDP in East Africa in 2004, as countries in the region experienced the terms of trade shock resulting from rising oil prices. Only Uganda improved its trade position slightly (by 0.2 per cent of GDP to a deficit of 9.7 per cent of GDP in 2004), reflecting a boost in its exports.

Southern Africa

The trade position of Southern Africa improved somewhat on average in 2004, as several countries benefited from the rise in prices of their principal exports (oil in Angola, aluminium in Mozambique, gold and platinum in South Africa, and copper in Zambia), and the coming on stream of its new aluminium smelter and gas pipeline boosted Mozambique's exports. As a result, the trade balance increased in Angola, Mozambique and Zambia (by 9 per cent, 7 per cent and 4 per cent of GDP, respectively), but it deteriorated in South Africa (by 2 per cent of GDP) owing to the strength of the rand coupled with strong domestic demand. Elsewhere, the large trade surplus also declined in Botswana (by 3 per cent of GDP in 2004), as diamond production started to reach a plateau.

The Millennium Development Goals: Progress Report

Reviewing the prospects of attaining the MDGs in Africa raises both optimism and critical concerns. There are serious and legitimate worries that Africa might not achieve the MDGs by 2015. In many Sub-Saharan African countries, the MDG growth requirements exceed to a great extent the best they have achieved in the recent past. At the same time, there are still encouraging stories of success and the possibility of achieving them if both donor and recipient countries take drastic measures.

A few countries appear to be on a way to reaching some of the MDGs. Cape Verde, Equatorial Guinea, Malawi and Uganda have already reduced poverty and Botswana, Mauritania and South Africa may reach some of the MDGs related to social development, but few will reduce poverty by half by 2015. Ghana, Morocco and Tunisia, however, should be able to fulfil growth-rate requirements.

In Table 5 – Progress Towards Achieving the Millennium Development Goals – countries are classified into five categories according to their pace of progress towards the MDGs:

i) Achieved: the country has already achieved the target or had achieved in 2000 half the pace to the target;

ii) On track: the actual growth rate of the indicator is equal to or higher than the required growth rate to achieve the target;

iii) Slightly off: the actual growth rate is between the required growth rate and half the required growth rate to achieve the target;

iv) Far behind: the actual growth rate is between zero and half the required growth rate to achieve the target;

v) Slipping back: the actual growth rate of the indicator is negative or the indicator is at least 5 per cent worse than the one in 1990.

The satisfactory performance ratio is the percentage of countries that has achieved or is on track to achieve the target. It gives an idea of the percentage of countries that should meet the target in 2015, on current trends.

Reaching the MDGs is about progress. To halve the monetary poverty in Zimbabwe means to reduce poverty from 36 per cent of people in 1990 to 18 per cent in 2015. The same target in Morocco means to reduce poverty from 2 per cent in 1990 to 1 per cent in 2015. Consequently, some results may appear counter-intuitive taking into account per capita income or social development.

Reducing Extreme Poverty by Half

Monetary poverty

This first target refers to halving the proportion of people whose income is less than one dollar a day. Only 6 African countries representing about 11 per cent of the regional population are likely to achieve this goal, most of them located in North Africa, namely: Algeria, Egypt, Libya, Morocco, Tunisia and Mauritius.

Hunger

In Sub-Saharan Africa, fewer than a third of countries are expected on current trends to halve the proportion of people who suffer from hunger before 2015. On average, people suffering from hunger represented 27.7 per cent of the African population in 2000-2002, but undernourishment reached 71.1 per cent in the Democratic Republic of Congo, 49.1 per cent in Zambia, 46.7 per cent in Mozambique, 46.5 per cent in Ethiopia, 44.1 per cent in Zimbabwe and 43.8 per cent in Tanzania. However, fewer than 10 per cent of people suffered from hunger in North Africa and in Nigeria (9.3 per cent), in Mauritius (8.3 per cent) and in Gabon (7.7 per cent).

Achieving Universal Education

Sub-Saharan Africa has the highest level of illiteracy in the world. In 2004, the estimated adult illiteracy rate (people over 15 years old) was 35.9 per cent in Africa (27.7 per cent for males and 44 per cent for females). The rate is lower for the younger tier (between 15 and 24 years of age) at 20.1 per cent. At the current slow pace of enrolment growth, Africa will not be able to achieve Universal Primary Education before at least 2150, according to the SAIIA (2004)[16]

Primary school enrolment

The most satisfactory enrolment ratio is for net primary education with 58.5 per cent of African countries on track to reach the target for 2015. Some countries are making outstanding progress. For example, Benin increased its primary enrolment rate by more than 20 percentage points in the 1990s and Botswana doubled the proportion of children in primary school in 15 years, nearly achieving universal primary education.

Completion rates

As a consequence of low completion rates, the average years of schooling for the adult population (15-64 years old) in 2000 ranged from 0.9 year in Burkina Faso, 1 year in Niger, 1.1 years in Mali to 7.4 years in

16. SAIIA (The South African Institute of International Affairs) (2004), *Back to the Blackboard – Looking beyond Universal Primary Education in Africa*, Nepad Policy Focus Series.

South Africa, 7.6 years in Mauritius and 8.3 years in Zimbabwe. However, Mali increased its primary completion rate by more than 20 percentage points in the 1990s and it is on track to reach the target. Ethiopia, Senegal and Rwanda are also making good progress on primary completion.

Eliminating Gender Disparity

Only goal 3 on eliminating gender disparity in all levels of education focuses on gender equality and women's empowerment. However, gender equality cannot be achieved only by eliminating gender disparities in primary and secondary schools. Goal 3, for instance, does not capture the difficulties of transition from school into the labour market. North African countries have made tremendous progress in educating girls but the region still has much to do in furthering women's economic and political participation. Cultural norms that often legitimise gender inequality and determine the position of women irrespective of educational attainment will need to be confronted in African countries.

Gender gaps in education are serious in sub-Saharan Africa. While the target for gender equality in primary and secondary education is to be achieved preferably by 2005, about 45.3 per cent of African countries appear unlikely to achieve it even by 2015. Continent-wide, 13 countries have achieved the goal of parity in primary education but only 7 in secondary education, including the outstanding cases of Botswana, Madagascar and Mauritius.

Improving Health

The health goals are rendered more difficult to achieve by the large gaps in access to safe drinking water and basic sanitation. Progress has been particularly weak and slow where civil disturbances and the HIV/AIDS epidemic have driven up rates of infant and child mortality.

Infant mortality and maternal health

Maternal mortality in Africa is one of the worst in the world, currently higher than 1 000 per 100 000 in Angola, Ethiopia, Mozambique and Rwanda. In 2004, the under-five mortality rate still exceeded 200 per 1 000 in Angola (240), the Democratic Republic of Congo (211), Mozambique (208), and Niger (203). In North Africa, the figures are far better and the mortality under five does not exceed 50 per 1 000. However, most countries are off track and none have achieved yet the target of a two-third reduction. While 11 countries are on track, another 11 have slipped back.

Major diseases

The goal of halting and reversing the spread of HIV/AIDS and other major diseases (malaria, tuberculosis) appears daunting. Their incidence continues to rise, further aggravating conditions affecting child and maternal mortality, and entailing broad and serious economic and social consequences. HIV/AIDS could undermine both the economic and social developments of Sub-Saharan Africa. Women and girls face extreme vulnerability to HIV/AIDS as a result of gender-based violence and discrimination.

At end-2003, 25.3 million people lived with HIV/AIDS in Africa and 12 million children were AIDS orphans. In North African countries, however, the rate of adult prevalence is no higher than 0.1 per cent. In East Africa, there are some encouraging signs that the prevalence of HIV/AIDS infection is declining. Uganda reduced HIV/AIDS infection rates during 8 consecutive years in the 1990s, from nearly 30 per cent in 1990 to 9 per cent in 2002, and Zambia may soon become the second African country to slow the spread of this scourge. However, East and Southern Africa are also the African regions where the prevalence of the infection is the highest. At the end of 2003, the adult (aged 15-49) prevalence rate for HIV/AIDS was 39 per cent in Botswana, 29 per cent in Zimbabwe, 22 per cent in South Africa, 19 per cent in Zambia, and 15 per cent in Mozambique. Over the last 5 years, there has been a rapid change in treatment strategies for HIV/AIDS infections. An increasing number of adults have been treated with antiretrovirals (ARVs). More than a quarter of the HIV-infected population in Botswana, Uganda and Namibia are currently under ARVs. However,

Table 5 - **Progress Towards Achieving Millennium Development Goals**

		Goal 1	Goal 2		Goal 3		Goal 4	Goal 7	
		Eradicate extreme poverty and hunger	Achieve universal primary education		Promote gender equality and empower women		Reduce child mortality	Ensure environmental sustainability Target	
Targets		Halve the % of people suffering from hunger	Ensure that all children can complete primary school		Eliminate gender disparity in all levels of education		Reduce by 2/3 under -5 infant mortality rates	Halve the % of people without access to safe water	Number of Goals on target to be achieved
Indicators HDI Rank		Undernourished people (as % of pop)	Net primary enrolment ratio (%)	Children reach grade 5 (%)	Female primary ratio as % of male ratio	Female secondary ratio as % of male ratio	Under five mortality rates (per 1000 lives)	Access to improved safe water (%)	
106	Algeria	Slipping back	On track	On track	On track	On track	Slipping back	Slipping back	**4 of 7**
161	Angola	Slightly off	On track	..	..	..	Slipping back	On track	**2 of 7**
158	Benin	On track	On track	..	Far behind	Far behind	Far behind	On track	**3 of 7**
126	Botswana	Slipping back	Achieved	On track	Achieved	Achieved	Slipping back	On track	**5 of 7**
169	Burkina Faso	On track	Slipping back	..	Far behind	..	Far behind	On track	**2 of 7**
171	Burundi	Slipping back	Slightly off	..	Far behind	..	Far behind	On track	**1 of 7**
135	Cameroon	Slightly off	Slightly off	..	..	..	Slipping back	On track	**1 of 7**
100	Cape Verde	..	On track	..	Achieved	Achieved	On track	On track	**5 of 7**
165	Central African Republic	Far behind	Far behind	..	..	..	Far behind	Achieved	**1 of 7**
166	Chad	On track	Far behind	Far behind	Far behind	Far behind	Far behind	On track	**2 of 7**
137	Comoros	Slipping back	Slightly off	..	..	On track	On track	Achieved	**3 of 7**
136	Congo	Slightly off	On track	..	On track	Far behind	Far behind	..	**2 of 7**
155	Congo, Dem. Rep.	Slipping back	..	..	On track	..	Far behind	..	**1 of 7**
156	Côte d'Ivoire	Slightly off	Slipping back	Far behind	Far behind	Far behind	Slipping back	On track	**1 of 7**
149	Djibouti	On track	Slipping back	Slipping back	Far behind	On track	Far behind	Achieved	**3 of 7**
115	Egypt	On track	On track	..	On track	On track	On track	Achieved	**6 of 7**
111	Equatorial Guinea	..	On track	..	..	..	On track	..	**2 of 7**
157	Eritrea	Far behind	Slightly off	..	..	..	On track	On track	**2 of 7**
168	Ethiopia	Slipping back	Far behind	..	Slipping back	Slipping back	Far behind	Slightly off	**0 of 7**
117	Gabon	Slipping back	Achieved	..	Achieved	..	Far behind	..	**2 of 7**
160	Gambia	Far behind	On track	..	On track	On track	Far behind	..	**3 of 7**
129	Ghana	Achieved	On track	..	On track	..	Slightly off	Achieved	**4 of 7**
159	Guinea	Slipping back	Far behind	..	On track	Far behind	On track	Far behind	**2 of 7**
167	Guinea Bissau	..	Far behind	..	..	..	..	..	**0 of 7**
134	Kenya	Far behind	Achieved	..	Achieved	On track	Slipping back	Slightly off	**3 of 7**
132	Lesotho	Slightly off	Achieved	..	Achieved	Achieved	Far behind	On track	**4 of 7**
...	Liberia	Slipping back	Slightly off	..	..	..	Far behind	..	**0 of 7**

64	Libya	Achieved	Achieved	..	..	..	On track	Far behind	**3 of 7**
147	Madagascar	Slipping back	Achieved	..	Achieved	Achieved	Far behind	Far behind	**3 of 7**
163	Malawi	On track	On track	..	Achieved	On track	Slightly off	Slightly off	**4 of 7**
164	Mali	Far behind	Far behind	On track	On track	Slipping back	Far behind	On track	**3 of 7**
152	Mauritania	On track	On track	Slipping back	On track	Far behind	Far behind	Far behind	**3 of 7**
67	Mauritius	On track	Achieved	On track	Achieved	Achieved	On track	Achieved	**7 of 7**
123	Morocco	Slipping back	On track	Far behind	On track	On track	On track	On track	**5 of 7**
170	Mozambique	Slightly off	Slipping back	..	Far behind	Far behind	Far behind	..	**0 of 7**
122	Namibia	Achieved	Achieved	..	Achieved	Achieved	Far behind	Achieved	**5 of 7**
172	Niger	Slightly off	Far behind	..	Far behind	..	Far behind	..	**0 of 7**
148	Nigeria	Achieved	Slightly off	..	Slightly off	..	Far behind	Slightly off	**1 of 7**
162	Rwanda	Far behind	Achieved	..	Achieved	..	Slipping back	..	**2 of 7**
119	São Tomé and Principe	..	On track	..	..	..	Far behind	..	**1 of 7**
154	Senegal	Slipping back	On track	On track	On track	Far behind	Far behind	On track	**4 of 7**
47	Seychelles	..	Achieved	On track	..	..	On track	..	**3 of 7**
173	Sierra Leone	Slipping back	..	..	On track	..	Far behind	..	**1 of 7**
...	Somalia	Slipping back	..	..	..	..	Far behind	..	**0 of 7**
107	South Africa	..	On track	..	On track	Achieved	Slipping back	On track	**4 of 7**
139	Sudan	On track	Slightly off	..	Slightly off	On track	Far behind	On track	**3 of 7**
125	Swaziland	Far behind	On track	Far behind	On track	On track	Slipping back	..	**3 of 7**
151	Tanzania	Slipping back	Achieved	Far behind	Achieved	On track	Far behind	Achieved	**4 of 7**
141	Togo	On track	On track	..	Far behind	Far behind	Far behind	Far behind	**2 of 7**
97	Tunisia	Achieved	Achieved	On track	Achieved	On track	On track	On track	**7 of 7**
150	Uganda	Slightly off	On track	..	On track	Far behind	Slightly off	Slightly off	**2 of 7**
153	Zambia	Slipping back	Slipping back	..	On track	..	Slipping back	On track	**2 of 7**
128	Zimbabwe	Far behind	On track	..	Achieved	Far behind	Slipping back	On track	**3 of 7**
	Achieved	**5**	**12**	**0**	**13**	**7**	**0**	**8**	
	On track	**10**	**19**	**7**	**16**	**12**	**11**	**19**	
	Slightly off	**8**	**7**	**0**	**2**	**0**	**3**	**5**	
	Far behind	**8**	**7**	**5**	**9**	**11**	**27**	**5**	
	Slipping back	**16**	**5**	**2**	**1**	**2**	**11**	**1**	
	No data	**6**	**3**	**39**	**12**	**21**	**1**	**15**	
	Total	**53**	**53**	**53**	**53**	**53**	**53**	**53**	
	Satisfactory Performance Ratio *(Achieved and On track)*	**28.3%**	**58.5%**	**13.2%**	**54.7%**	**35.8%**	**20.8%**	**50.9%**	

Sources: FAO, The State of Food Insecurity in the World 2004; World Bank, World Development Indicators 2004; Unesco Database, 2004; UNDP Country Report on MDGs; UNDP, Human Development Reports, 2003 and 2004; UN Population Division, World Population Prospects, the 2002 Revision.

Box 5 - Scaling up Antiretroviral Treatment in Africa: Challenges Ahead

ARV programmes have recently been initiated in several African countries. The WHO "3 by 5" initiative, which is an integrated strategy to fight AIDS through the association of prevention, treatment and long term support, seeks to provide ARVs to 3 million people living with AIDS in developing countries by the end of 2005. In tandem with this initiative, the private sector is increasingly involved in the fight against the pandemic, in particular through the Global Business Coalition on HIV/AIDS, a pool of 180 international enterprises.

A constraining treatment regimen

In order for the ARV therapy to be effective, a regular pill intake should be respected and combined with a good nutritional status. Moreover, the treatment should be extended over a long period of time. Inadequate adherence to treatment gives rise to the surge of detectable viral loads, declining CD4 counts, disease progression, episodes of opportunistic infections and poorer health outcomes. Poor adherence also leads to the development of resistance to ARVs. This is a major public health problem in resource-limited situations where the choice of medications is already restricted due to high costs and limited availability.

Capacity and financial challenges

Health systems in Sub-Saharan Africa already suffer from *capacity problems* and *financial inadequacy*. The HIV/AIDS epidemic is exacerbating these problems. In Côte d'Ivoire and in Uganda, 50 to 80 per cent of hospital beds are occupied by patients showing HIV/AIDS symptoms. Increasing demand for health services faces limited supply of services, such as safety and hygienic requirements and trained staff. Despite a spectacular decrease in the cost of ARVs, access to treatment remains expensive and the availability of it too limited to cover the population in need. To complicate this setting, poverty can further harm adherence through inadequate food intakes.

The way forward

In order to ensure an effective implementation of the ARV therapy, whose failure would engender supplementary costs, both human and economic, the following key actions need be promoted:

1 Integrating **prevention** and **treatment** programmes: the effort of prevention is essential to prevent new infections and to increase awareness about the existence of effective treatment as well as about its binding conditions.

2 Ensuring the strict implementation and scaling up of ARV therapy, which will require putting in place a series of incentives, such as **food aid** or **financial support** for afflicted households;

3 Raising **supplementary funds** in order to enhance the entire health system and thus avoid treatment inefficiency and crowding out of other illnesses;

4 Improving **policy coherence and co-ordination among partners** (government agencies, civil society, multilateral and bilateral

daunting challenges remain for the effective implementation and scaling up of the antiretroviral therapy (Box 5).

The prevalence of tuberculosis has surged at the same time as the spread of the HIV pandemic. In 2003, 227 320 cases of tuberculosis were notified in South Africa, 117 600 in Ethiopia, 91 522 in Kenya and 84 687 in Democratic Republic of Congo.

The continent's temperatures, mosquito species and humidity also give Africa the highest malaria burden. Notified cases represented 4.3 million in Kenya in 1995, 3.2 million in Zambia in 1996, 2.2 million in Ghana in 1997 and 1.1 million in Tanzania in 1997.

Environment

Halving the proportion of the African population without access to safe drinking water and sanitation between 1990 and 2015 should help ensure environmental sustainability. Progress has been good in this area and performance is now satisfactory in more than half of the African countries.

In 2002, access to water supply was still very low in Ethiopia (22 per cent), Chad (34 per cent), Mozambique (42 per cent) or Madagascar (45 per cent). In contrast, it was high in Egypt (98 per cent), Botswana (95 per cent) and South Africa (87 per cent). Global figures, however, do not reflect the important disparities existing in some countries between rural and urban areas. For example, while 81 per cent of the urban population has access to water in Ethiopia, only 11 per cent of the rural people have access.

Sanitation coverage in 2002 was very low in Ethiopia (6 per cent), Chad (8 per cent), Congo (9 per cent), Burkina Faso and Niger (12 per cent) but high in Mauritius (99 per cent) and Algeria (92 per cent). Again, the difference between urban and rural areas is very important in Tanzania (71 per cent of urban people have access to sanitation against 15 per cent in rural areas), in Morocco (83 per cent against 31 per cent), in Benin (58 per cent against 12 per cent) and in South Africa (86 per cent against 44 per cent).

Governance and Political Issues

The promotion of good governance has been an important focus of development efforts by African governments since the early 1990s. The two regional initiatives – the African Union and the New Partnership for African Development (NEPAD) – have re-affirmed that development requires democracy, the respect for human rights, peace and good governance. The African Peer Review Mechanism (APRM) launched in 2003 is expected to provide a candid assessment of the situation in African countries and foster progress in such areas as peace and security, democracy and political governance, and economic and corporate management. Indeed, democracy has started taking root in a number of countries over the last ten years, and in parallel conflicts have started subsiding. Corruption, however, continues to be prevalent in many countries. There has been progress in macroeconomic management and the regulatory environment, but more needs to be done to ensure sustainable private sector development.

Progress Towards Democracy

As part of the democratisation taking place in Africa, substantial progress has been made in the electoral process. Political parties, the machinery for democratic control of political power now flourish in many African countries. According to a survey by the United Nations Economic Commission for Africa – UNECA, (2005)[17] liberalisation in registration of political parties has led to several parties in countries such as South Africa (with 140 parties), Mali (91), Ethiopia (79), Chad (73), Senegal (65), Kenya (48), Burkina Faso (47), Morocco, Nigeria and Botswana (30 each), Egypt (17) and Ghana (10). Voter registration is conducted easily in South Africa, Mauritius, Namibia, and Botswana – but not in Zimbabwe. The electoral laws and procedures across the continent have enhanced competition in the electoral system in many countries. Moreover, internal reforms and significant external support given to electoral commissions have given them greater capacity and competence to manage elections. The electoral system is considered legitimate and credible in Ghana, South Africa, Mali, Mauritius, Botswana, Senegal, Namibia, Benin, Niger, Burkina Faso, Gambia, Lesotho, Malawi, Morocco, Nigeria, Cameroon, and Mozambique. Nonetheless, in most countries, political parties are weak, highly personalised, lacking in internal democracy and are without good funding base.

Along with the increasing political competition, the existence of checks and balances across different branches of government, as well as external monitoring by civil society is promoting political accountability. Several

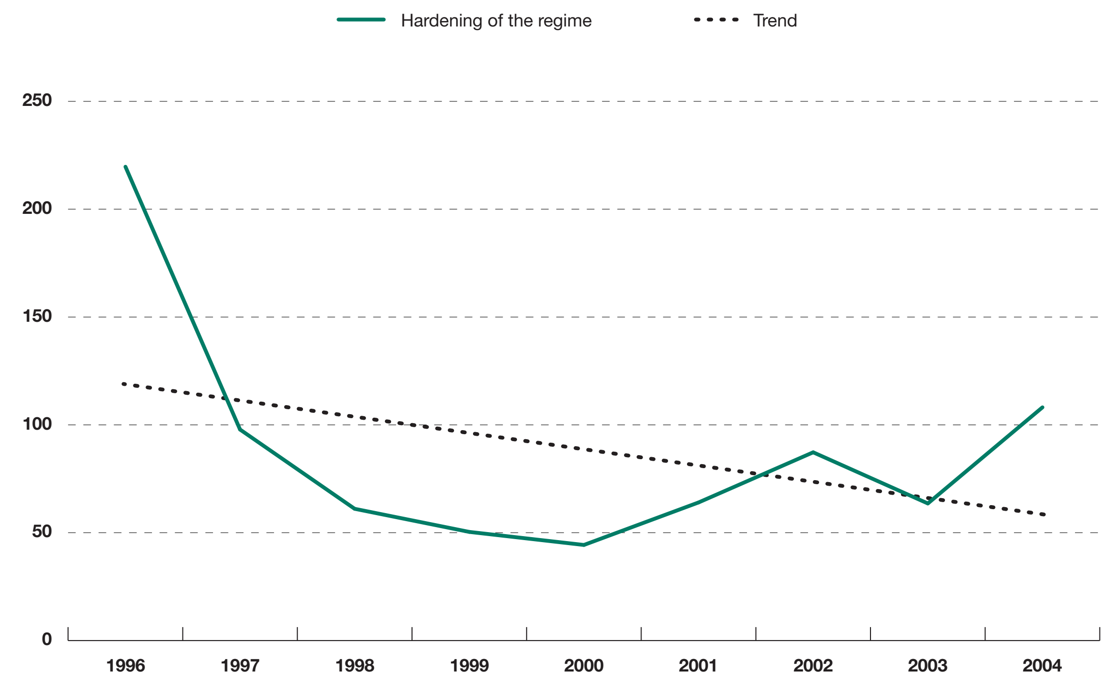
17. See, UNECA (2005) Striving for Good Governance in Africa. Synopsis of the 2005 African Governance Report Prepared for the African Development Forum IV, UNECA, Addis Ababa.

African countries over the years have witnessed declines in key institutions such as the police, the judiciary, the prisons, and other institutions essential to ensuring the rule of law and security. The situation appears to be changing in many countries as legislatures and judiciaries are providing realistic checks on the executive. As reported in the UNECA survey (2005), the legislature is largely independent from other branches of government in South Africa, Namibia, Botswana, Uganda and Ghana. Other countries have set reforms in motion to improve the independence, integrity and performance of the judiciary. At the same time, across other countries the judiciary is hampered by serious institutional constraints including inadequate funding, insufficient professional personnel, lack of regular training for judicial officers, especially for magistrates in the lower courts, registrars and court clerks. These constraints lead to delays in the dispensation of justice with criminal cases taking on average 1-2 years to be heard in the courts, and in some extremes, 3-4 years.

The strengthening of democracy has contributed to a lessening of political repressions (as defined by "hardening" in the statistical annexes to this volume) across the continent in the last decade, as more governments have adhered to the rule of law and respect for human rights (Figure 8). The upholding of civil rights and liberties has improved in countries including Cameroon, Kenya, Nigeria and South Africa. However, in others such as Côte d'Ivoire, Zimbabwe and Equatorial Guinea, the authorities have countered rising instability by hardening their political stance.

Despite the positive developments in democracy, much remains to be done to improve citizens' influence

Figure 8 - **Political Hardening in Africa, 1996-2004**



Source: Based on Appendix Table 23.

and oversight over the conduct of the government, elect responsive and responsible leadership and promote social reciprocities in some parts of Africa. There are still many parts of the continent where progress needs to be made towards greater adherence to the axioms of good politics including basic political order, political legitimacy and rule of law. Furthermore, there are still cases where democracy is superficially based on ethnic elections that do not reflect the judgment of the people on the performance of the government.

The degree of political equality, inter-group tolerance, inclusiveness, and popular participation needs to be greatly improved.

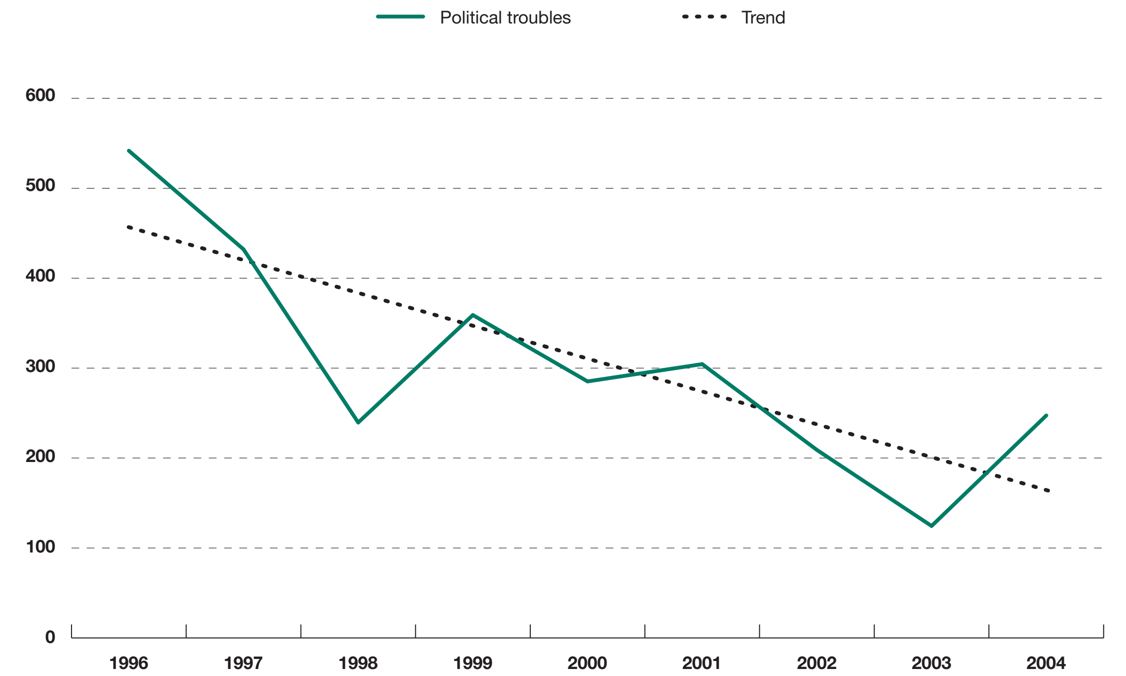
Conflicts and Political Troubles in Africa

Conflicts in Africa are subsiding as electoral democracy is taking root. Several long-running wars have recently ended. Reconstruction is under way in Angola – after 27 years of war – Sierra Leone, Liberia and Guinea-Bissau. Also, an end to conflict is in sight for Democratic Republic of Congo, Burundi, Somalia, and Senegal's Casamance province.

The reduction in conflicts across Africa has coincided with a marked decline in political instability throughout the continent (see Figure 9). Over the last decade, political instability has dropped in Algeria, Cameroon, South Africa, Egypt and Kenya, while political troubles have recently been on the rise in Côte d'Ivoire.

War, however, remains the strongest threat to democracy and human rights in Africa. The Democratic Republic of Congo is in the middle of transition to peace and democracy, but new fighting in the east could

Figure 9 - **Political Troubles in Africa, 1996-2004**



Source: Based on Appendix Table 21.

threaten that progress. In Côte d'Ivoire and in Sudan's Darfur region, the conflicts have lingered.

Corruption in Africa

Corruption remains the bane of good governance and good economic management in Africa. During the 1970s, extensive governmental intervention and regulation of public life in most African countries created the basis for corrupt practices. The roll back of the state since the early 1980s has failed to reduce corruption in Africa.

The extent to which corruption continues to be prevalent in African countries is apparent from the

18. The CITI measures the perception of corruption as seen by business people, risk analysts and the general public. The index is ranked on a scale of 0-10, with a lower score indicating high corruption.

Corruption Index of Transparency International (CITI).[18] The 36 African countries covered in the CITI in 2004 scored an average of 2.93, indicating widespread corruption (Table 6). Among the African countries, only Botswana and Tunisia obtained scores that were half-way towards a corruption-free environment. Botswana obtained the best score among African countries (6 points), and was ranked 31st among the 146 countries covered. This score was marginally comparable to only one European country – Portugal (6.3). Corruption levels are higher in Africa's oil rich countries including Angola, Chad, Libya, Nigeria and Sudan. Nigeria continued to register the worst record of all the African countries with a score of 1.6 points, which was only better than the score for two other countries – Bangladesh (1.5) and Haiti (1.5). The CITI

Table 6 - **Corruption Perception Indexes (CPI) for African Countries, 2000, 2002 and 2004**

Country	Global rank 2004	CPI 2004	Confidence interval	CPI 2002	CPI 2000
Botswana	31	6.0	5.3-6.8	6.4	6.0
Tunisia	39	5.0	4.5-5.6	4.8	5.2
South Africa	44	4.6	4.2-5.0	4.8	5.0
Seychelles	48	4.4	3.7-5.0	-	-
Mauritius	54	4.1	3.2-4.8	4.5	4.7
Namibia	54	4.1	3.5-4.6	5.7	5.4
Ghana	64	3.6	3.1-4.1	3.9	3.5
Gabon	74	3.3	2.1-3.7	-	-
Benin	77	3.2	2.0-4.3	-	-
Egypt	77	3.2	2.7-3.8	3.4	3.1
Mali	77	3.2	2.2-4.2	-	-
Morocco	77	3.2	2.9-3.5	3.7	4.7
Madagascar	82	3.1	1.8-4.4	1.7	-
Senegal	85	3.0	2.5-3.5	3.1	3.5
Gambia	90	2.8	2.2-3.4	-	-
Malawi	90	2.8	2.2-3.7	2.9	4.1
Mozambique	90	2.8	2.4-3.1	-	2.2
Tanzania	90	2.8	2.4-3.2	2.7	2.5
Algeria	97	2.7	2.3-3.0	-	-
Eritrea	102	2.6	1.6-3.4	-	-
Uganda	102	2.6	2.1-3.1	2.1	2.3
Zambia	102	2.6	2.3-2.9	2.6	3.4
Libya	108	2.5	1.9-2.9	-	-
Congo	114	2.3	2.0-2.7	-	-
Ethiopia	114	2.3	1.9-2.9	3.5	3.2
Sierra Leone	114	2.3	2.0-2.7	-	-
Zimbabwe	114	2.3	1.9-2.7	2.7	3.0
Niger	122	2.2	2.0-2.5	-	-
Sudan	122	2.2	2.0-2.3	-	-
Cameroon	129	2.1	1.9-2.3	2.2	2.0
Kenya	129	2.1	1.9-2.4	1.9	2.1
Angola	133	2.0	1.7-2.1	1.7	1.7
Congo, Dem. Rep.	133	2.0	1.5-2.2	-	-
Côte d'Ivoire	133	2.0	1.7-2.2	2.7	2.7
Chad	142	1.7	1.1-2.3	-	-
Nigeria	144	1.6	1.4-1.8	1.6	1.2

Source: Transparency International.

suggests that corruption levels increased in Africa between 2000 and 2004.

The deterioration in the corruption index across Africa masks the efforts made by several countries in the recent past to fight corruption. Many countries now have legislation to impede corrupt practices, and stringent penalties for those engaging in them. Others have enacted codes of conduct for public officers, while some have created specialised agencies for combating corruption, as in Ghana, Kenya, Malawi, Nigeria and Tanzania. The persistence of high levels of corruption across the region, however, suggests that existing laws have been implemented ineffectively.

Economic Governance

Most African countries have pursued reforms promoting market economies. The significant improvements that have been achieved in their macroeconomic management and the regulatory

Table 7 - African Index of Economic Freedom

2004 rank	Country	2004 score	2000 score	1996 score
	Sub-Saharan Africa			
39	Botswana	2.55	2.93	3.09
48	Uganda	2.7	3.15	2.89
53	South Africa	2.79	3.01	3.25
60	Cape Verde	2.86	3.66	3.6
70	Namibia	2.96	2.98	n.a.
71	Mauritius	2.99	2.9	n.a.
72	Senegal	3	3.34	3.61
86	Madagascar	3.14	3.39	3.55
89	Côte d'Ivoire	3.18	3.68	3.83
89	Swaziland	3.18	3.16	3.3
92	Djibouti	3.23	3.38	n.a.
93	Guinea	3.24	3.34	3.13
94	Kenya	3.26	3.05	3.54
95	Burkina Faso	3.28	3.61	3.96
95	Mozambique	3.28	3.94	4.11
98	Tanzania	3.29	3.58	3.73
101	Ethiopia	3.33	3.7	3.8
102	Mali	3.34	3.13	3.44
103	Rwanda	3.36	4.28	n.a.
105	Central African republic	3.38	n.a.	n.a.
109	Ghana	3.4	3.24	3.54
111	Gabon	3.43	3.26	3.4
111	Niger	3.43	4.09	4.25
113	Benin	3.44	3.16	3.53
114	Malawi	3.46	3.84	3.64
118	Lesotho	3.5	3.44	3.78
118	Zambia	3.5	2.94	3.08
124	Chad	3.54	4	n.a.
124	Gambia	3.54	3.64	n.a.
127	Cameroon	3.63	3.73	4.08
130	Equatorial Guinea	3.69	4.18	n.a.
134	Sierra Leone	3.73	4.04	3.65
134	Togo	3.73	4.05	n.a.
139	Congo	3.9	4.2	4.39
139	Guinea Bissau	3.9	4.4	n.a.
142	Nigeria	3.95	3.39	3.53
153	Zimbabwe	4.54	4.04	3.79
-	Angola	n.a.	4.48	4.38
-	Burundi	n.a.	4	n.a.
-	Congo Dem. Rep.	n.a.	4.6	4.29
-	Sudan	n.a.	4.05	4.1
	North Africa			
66	Morocco	2.93	3.05	2.89
67	Tunisia	2.94	2.94	2.83
67	Mauritania	2.94	4	3.93
95	Egypt	3.28	3.58	3.4
100	Algeria	3.31	3.4	3.7
154	Libya	4.55	4.85	4.95

Source: Heritage Foundation/Wall Street Journal 2004 Index of Economic Freedom.

environment are yielding positive economic outcomes. As indicated in the Annual Index of Economic Freedom produced by the Heritage Foundation and Wall Street Journal (Table 7)[19], "economic freedom" has improved in most African countries, including in particular in Rwanda, Ethiopia, Cape Verde, Senegal, Mauritius, Mozambique and Mauritania. In contrast, the situation has deteriorated in Zimbabwe, Nigeria and Zambia; with Zimbabwe being the least free country in the region.

In spite of the improving regulatory environment, there are still numerous challenges and bottlenecks to private-sector development in the region. These include a range of constraints that lead to a high cost of doing business in the continent, as a result of policy uncertainty, inadequate physical infrastructure, poor access to investment capital and banking services and cumbersome procedures and regulations governing the establishment and operation of businesses.

Financing SME Development in Africa

Very small enterprises predominate in the African private sector. They are the vast majority of firms and provide the most substantial share of employment, but they are often "hidden" in the informal sector. Their small size reflects both the recent emergence of the private sector in Africa and the legal and financial constraints that hinder capital accumulation. Like very small companies, big firms have developed or remained in place, their size allowing them to bypass the constraints and overcome the shock-prone African business environment. In between, SMEs have remained very few, constituting the "missing middle".

This year's African Economic Outlook sheds light on SMEs in Africa and on the constraints that prevent firms from growing, focusing specifically on access to finance. In a second section, the report highlights successful initiatives to remedy to the financial constraint and offers ways forward based on emerging trends.

Drawing on the often disappointing experiences with SME promotion programmes, supported by the donor community during the last decade, helping SMEs to emerge and grow to their efficient size, will require sustained efforts. A multi-pronged approach is needed, dealing with the major existing impediments, including a poor business environment, lack of financial tools, weak entrepreneurial capacity, and the absence of strong linkages with existing large enterprises.

SMEs in Africa and their Limited Access to Financing

A snapshot of the SME sector in Africa

African countries are very heterogeneous in terms of private sector development. While a thriving SME sector has developed in South Africa, Mauritius and North Africa, elsewhere, however, recent conflicts or heavy reliance on a few commodities have prevented the emergence of a class of SME entrepreneurs. In between, countries, such as Senegal and Kenya, have put in place the elements for the development of their private sector and are, indeed, starting to witness the emergence of a dynamic class of entrepreneurs. One common feature across African countries, however, is: the coexistence of very small firms with big entities and the quasi absence of SMEs.

The SME sector in Africa

Data on SMEs in Africa are scarce and generally not readily comparable across countries. Nevertheless, some patterns are clearly identifiable, highlighting the importance of a stable political environment, of economic diversification and of an adequate financial sector for SME development.

19. The Index of Economic Freedom measures how well countries score on a list of 50 independent variables divided into 10 broad factors of economic freedom. They are: trade policy; fiscal burden of government; government intervention in the economy; monetary policy; capital flows and foreign investment; banking and finance; wages and prices; property rights; regulation; and informal market activity.

Box 6 - Small and Medium-sized Enterprises in Africa: Definition Issues

Data is scarce and there is little consistency in definition across or even within African countries. Few have adopted an operational definition, with the notable exception of the UEMOA countries, Mauritius and Morocco.

An international definition is of little relevance since one drawn from an OECD-type environment could be applied to virtually all African enterprises. It would also exclude the informal sector that is a substantial part of private-sector activity on the continent.

A definition based on the profile of the entrepreneurs and their strategy, such as that adopted by RAMPE (Réseau Africain pour la Micro et Petite Enterprise), appears to be more relevant than purely quantitative criteria. According to such an approach:

- Micro enterprises are family businesses using simple technology and aiming at subsistence activity; while
- Small enterprises are those whose owners possess some managerial and technical skills. Even if relying on family members, they are usually registered, pay taxes and might participate in a professional organization; and
- Medium-size enterprises involve substantial working capital, specific technology and therefore a medium to long-term vision on the part of the entrepreneurs. These firms are formal sector and pay regular taxes.

In the countries at war, or in reconstruction – such as **Angola, Rwanda and the Democratic Republic of the Congo (DRC)** – the private sector is very small and almost entirely informal. Formal finance is non existent and informal sources of finance – such as tontines – are very little organised. Alongside big companies, usually operating in the extractive industry, which are able to protect their activity and continue doing business in war time, the private sector is mainly constituted of micro, survivalist enterprises whose finance is based on family solidarity. In the DRC, for instance, most small companies went bankrupt in the 1990s, either following the pillaging which occurred between 1993 and 1996 or during the war. The progressive decline in living standards has led to very strong development of the informal production sector in line with household survival strategies. The bulk of the revenues from small companies' activity is devoted to consumption within the household and not to investment and company growth. Technology is obsolete and productivity is very low. Lack of technical and managerial competence and financial resources and, above all, the lack of security are major obstacles to the development of these companies.

In oil-producing countries – such as **Chad, Congo, Equatorial Guinea or Gabon –** the predominance of the oil sector has prevented the emergence of a private non-oil sector. Public policies are characterised by the absence of a private-sector development strategy, despite a need for diversification. High levels of corruption, documented for instance by Transparency International, place an additional burden on SME development. Consequently, enterprises tend to concentrate in the tertiary sector (services and commerce such as pharmacies and bakeries in Gabon), remain small (almost 80 per cent of enterprises in Congo employ fewer than five people) and informal (for 2 100 enterprises registered in the formal sector, there are 10 000 informal ones in the Congo).

In more stable countries, including **Benin, Burkina Faso, Ethiopia, Mali and Zambia**, the SME sector is more developed but remains very small. Though private activity is still mostly informal, some SMEs have managed to thrive, notably in the trade and agribusiness sectors, capitalising on the countries' overwhelming agriculture sectors. In a 1997 census in Benin, for instance, half of the 666 identified SMEs were operating in trade, while the remaining were in construction, pharmacy and restaurants. Only 17 per cent of them were in manufacturing. In this third group of countries, formal finance is developing, with the banks dominating the financial system but with insufficient outreach. SME's access to finance is limited to the funding provided by the specific SME financial schemes established with the support of the donor community and the services of the micro-finance institutions.

Fairly developed private sectors in **Kenya and Senegal** can be explained by their relatively good business environment. Kenya, for instance, has a sizeable SME sector employing about 3.2 million people and contributing about 18 per cent of total GDP in 2003. In Senegal, the SMEs are estimated to contribute around 20 per cent of value added produced in the country. However, the financial system in both countries remains underdeveloped and access to financing constitutes a major bottleneck to private sector development. In **Nigeria,** SMEs play a major role in the economy as they account for about 95 per cent of the firms in the organised manufacturing sector and about 70 per cent of industrial employment. Over the years, the government has introduced numerous financial-assistance schemes for SMEs, although with limited success. Promoting SME support institutions and schemes has proven insufficient in an overall hostile business climate. The main obstacles to SME's development are insecurity, corruption, and inadequate infrastructure.

At the other end of the spectrum, **Mauritius, South Africa** and several North African countries – **Tunisia, Egypt and Morocco** – have buoyant private sectors based on dynamic SMEs. In Morocco, SMEs constitute the bulk of the industrial sector, accounting for 93 per cent of total firms, 38 per cent of production, 33 per cent of investment, 30 per cent of exports and 46 per cent of employment. The financial system is relatively developed in Southern and Northern Africa, and there are active stock markets. The banking system provides a wide range of financial services, including leasing and factoring (purchase of accounts receivable by the lender). Private-sector initiatives to support SMEs have developed, including franchising and subcontracting activities. Although some SMEs still suffer from limited access to finance, they can benefit from the various schemes put in place by dynamic public institutions. In Northern African countries, however, the banking sector suffers under a high rate of non-performing loans amounting in 2003 to 23 per cent in Egypt, 18 per cent in Morocco and 24 per cent in Tunisia. In parallel, micro-finance institutions limit their activities to lending to the poorest and do not offer deposits or savings products.

A common pattern: the "missing middle"

With few exceptions, the private sector in Africa consists of a vast majority of micro-scale, informal firms that co-exist with large-scale enterprises. Small and medium-size enterprises remain scarce. This pattern is very obvious in the first two groups of countries, where SMEs are virtually absent, but remains similar in countries with a more developed SME sector. In South Africa, for instance, micro and very small enterprises still accounted for more than 55 per cent of total employment and 22 per cent of GDP in 2003. Small enterprises accounted for 16 per cent of both employment and production and medium and large companies for 26 per cent of employment and 62 per cent of production. In a 2002 survey, based on a different methodology, large companies were estimated to generate 64 per cent of the country's GDP.

The under-development of the SME sector can be explained by a series of structural elements. In a difficult context due to the small size of domestic markets and limited regional integration, enterprises also face an adverse business environment. Bureaucracy remains heavy, encouraging the growth of a large informal sector. Infrastructure is still largely deficient, notably in the telecommunications, power and transport sectors, and imposes a high indirect cost on activity. The lack of credibility in the judicial system constitutes a big obstacle to contract enforcement, though more and more countries are undertaking reforms. Financial intermediation is underdeveloped; tax systems encourage informality and limit the development of innovative financial tools.

To compare business environments across countries, the World Bank has developed key indicators[20]. Some African countries present very efficient business environments, even by OECD standards, but the vast

20. The Doing Business database includes 32 African countries. Mauritius and Gabon are missing as they are below the population cut-off point.

majority is still characterised by lengthy and costly administrative procedures. North African countries, especially Morocco and Tunisia, and Southern African countries, mainly Botswana, South Africa and Zambia, are outstanding in terms of number, time length of procedures and costs of starting and closing businesses, registering property and in terms of contract enforcement. Starting a business takes only 11 days in Morocco and 14 days in Tunisia (against an average of 25 days in OECD countries) while enforcing a contract requires only 17 and 14 procedures respectively (against an average of six in the OECD area). By contrast, Angola, Chad and DRC are striking examples of lengthy and costly business procedures. In Angola, starting a business takes 146 days and enforcing contract 1011 days. In the DRC, the cost of starting a business is six times the average income per capita and closing a business takes more than five years.

The losses due to a bad business environment largely explain why indirect costs (relative to levels of income and productivity) are higher in Africa[21]. The importance of indirect costs is likely to drive SMEs out of business, as they are highly dependent on national inputs and local market. By contrast, the activity of large, offshore firms is not affected.

Lack of infrastructure is another major bottleneck to manufacturing productivity growth in Africa[22]. Sub-Saharan African countries are characterised by higher levels of physical capital, almost at par with the rich countries, and lower levels of infrastructure, a feature that supports the view of some substitutability between the two. Anecdotal evidence shows, indeed, that the manufacturing sector makes wide use of private capital as a substitute for deficient public utilities (97 per cent of manufacturing firms in Nigeria have their own generators, according to a World Bank survey). A major concern of private substitution lies in its cost: firms are spending a considerable amount of capital on the private provision of infrastructure (in the power sector and other public utilities) and this burden decreases as the size of the firm increases. This finding contributes to explaining the "missing middle" as the self provision of infrastructure capital, responding to public inefficiencies, can hardly be afforded by firms under a critical size due to indivisibilities and economies of scale in the cost structure.

Consequently, many businesses remain small and informal, relying on simple technology that requires only little use of infrastructure. Their smallness also prevents legal action, as, for instance, no assets can be seized in case of default. It is a form of enterprise that allows more flexibility in the face of an unstable environment. By contrast, bigger entities have the means to escape legal and financial constraints. They have higher bargaining power and are often well connected, which allows them to obtain preferential treatment. They are more insulated from the domestic economy thanks to their access to foreign finance, technology and markets – through the companies to which they are affiliated, for example. Economies of scale make it easier for them to afford investing in the missing public utilities.

Limited Access to Finance

Limited access to finance is a major obstacle to private-sector development. It prevents start ups, or does not allow them at the appropriate scale, a crucial determinant of survival. It also hampers their subsequent growth. In Africa, retained earnings and informal saving and credit associations – *tontines* – remain the most important sources of SME financing. However, their financing is limited, suffers from lack of reliability and predictability and offers little scope for risk mitigation because of regional or sectoral concentration. Access to formal sources of finance remains poor owing to the inherent higher perceived risk of SMEs, which makes financial institutions reluctant to engage in lending activities with them, but also to the limited availability of adequate financial instruments.

21. Eifert, B., A. Gelb and A. Ramachandran (2005), *Business Environment and Comparative Advantage in Africa: Evidence from the Investment Climate Data*, Center for Global Development Working Paper.

22. Causa, O. and D. Cohen (2004), *Overcoming Barriers to Competitiveness*, OECD Development Centre Working Paper No. 239.

Lack of capacity, costs and perceived risks

Small entrepreneurs in Africa are seldom able to comply with the prerequisites of financial institutions. They are unable to put bankable proposals together or to provide accounting records and official registration.

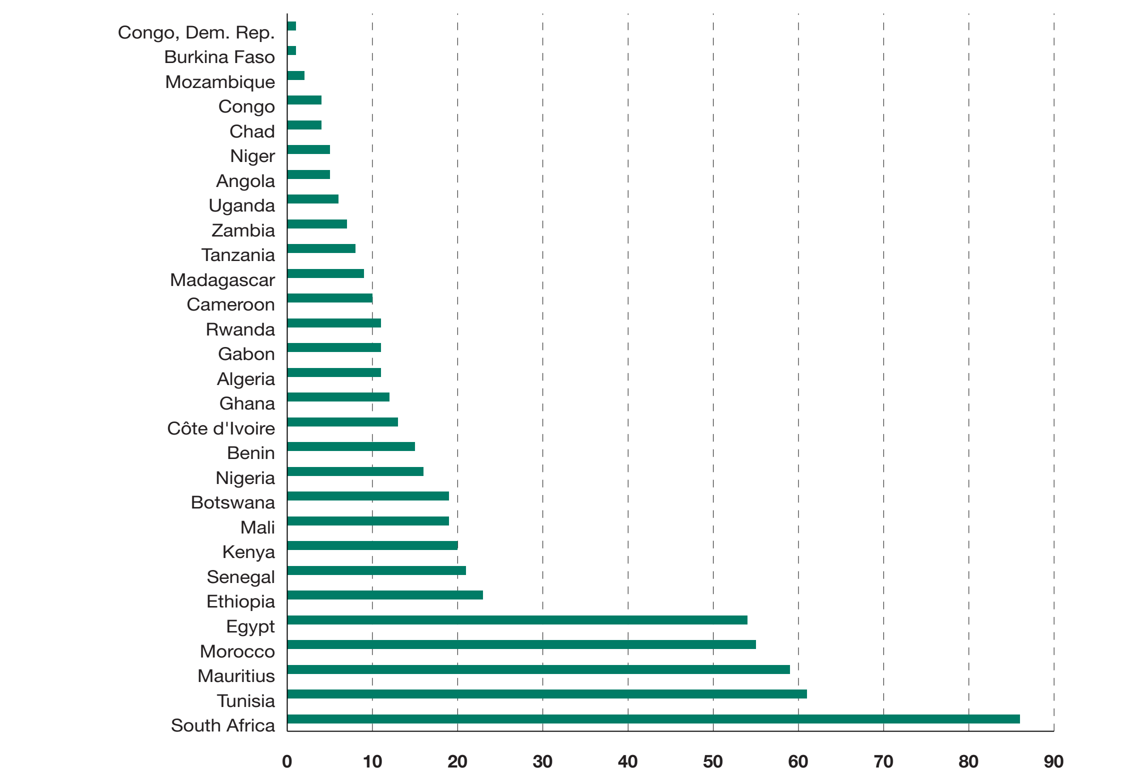
Conversely, the financial institutions are not always able or willing to assess properly the proposals made by small enterprises because of the costs involved. Collecting information on SMEs and monitoring their performance is time-consuming. The expected returns for the financial institutions might not cover the cost of project evaluation.

SMEs are perceived as more risky to finance, which results in both higher interest rates and denied access to finance. SME entrepreneurs are deemed to have little creditworthiness owing to the lack of information available on their credit performance, the lack of adequate collateral and to the nature of businesses in Africa (often involving several different activities and relying heavily on the family) in a shock-prone environment.

Underdeveloped and ill-adapted financial institutions

In most African countries, the financial system is underdeveloped – as shown by the limited share of credit to the private sector in terms of GDP – and therefore provides few financing options. With the exceptions of South Africa and the North African region,

Figure 10 - **Share of Credit to the Private Sector in 2003** (percentage of GDP)



Source: IMF International Financial Statistics.

capital markets remain embryonic. Equity finance is limited – even in South Africa – owing to the lack of exit options from investments in SMEs. Long-term financing instruments are conspicuous by their absence.

The local banking systems remain highly risk-averse as a result of their recent history of bank collapses and the subsequent tightening of bank regulation. Banks tend to focus their lending activities on less risky and more profitable businesses, such as sovereign and consumer lending. Consequently, banks are mainly concentrated in urban areas, close to their natural clientele. Their size, their distance from the field and their adherence to international banking regulation make them reluctant to finance local initiatives.

Non-bank financial intermediaries – such as micro-finance institutions (MFIs) – could play a significant role, especially by lending to small enterprises, but have little capacity to follow their clients as they grow. MFIs are usually sector-biased towards agriculture and trade activities, against craft and manufactured industry. They also usually provide finance to already existing SMEs and rarely to start-ups. MFIs mainly supply short-term credits, with interest rates close to the usury rate (around 2 per cent per month). The amounts are small, below 7 500 euros. These elements make MFIs potential providers of working capital finance but hardly for capital extension. Even if the MFIs could grow, financial rules are very stringent and often confine the MFIs to micro lending. Consequently, in Sub-Saharan Africa, the micro-finance sector remains marginal and accounts for less than 1 per cent of GDP.

Improving SME Access to Finance: a Four-pronged Approach

Unfriendly macroeconomic and business environments together with a lack of capacity on the part of SMEs and of the financial institutions constitute substantial constraints to SME access to finance. Reversing this will require efforts to improve the business climate, strengthen SME capacity to help them to cope with formal banking requirements, promote financial-sector development and to diversify sources of financing, notably by encouraging business-to-business lending.

Improving the business environment

Africa has achieved good results over the last decade in macroeconomic stabilisation and few African countries today still experience high inflation and government bankruptcy. In contrast, Africa has been slow to improve the business environment. It is nevertheless a crucial determinant of SME access to finance. In particular, the availability of information on existing financial schemes and SME performance is needed in the context of a sound legal and judicial environment and pro-SME public policies.

Improving the information environment

Promoting accounting standards and credible independent accounting firms is a key to helping SMEs develop their accounting documents. Third-party information exchanges and credit bureaux are instrumental tools to promote the availability of information on payment performance. Several countries are currently establishing a credit information facility. They expect the screening process to become less costly to banks as reliable firms will be able to lower their perceived associated risk.

Legal, judicial and bankruptcy environment

As well as establishing a sound judicial system to facilitate contract dispute resolution, reforming the commercial laws that specify property rights, and ensuring their enforcement, together with promoting land titling, are essential steps to set proper incentives for commercial transactions. Allowing the actors to exit the system rapidly and at minimum cost through an efficient bankruptcy system is also critical.

Tax, administrative and regulatory environments

Governments can create incentives for small entrepreneurs to enter the formal economy by simplifying taxes for small firms. In that perspective, some countries – in UEMOA for instance – are developing lump-sum taxes as incentives for SMEs to register.

National authorities are increasingly aware of the potentially adverse impacts of their choice of regulatory framework. For instance, changes in capital regulation and tougher bank supervision can lead to a reduction in the supply of credit. Policies regarding the entry of financial institutions (restriction of foreign entry for instance) or their market shares also affect the lending infrastructure. In South Africa, for instance, a task group has been established with the aim of identifying regulatory obstacles to SME access to finance.

Finally, governments should pay special attention to expediting their payments to SMEs, since public contracts constitute a crucial element of their financial sustainability.

Helping SMEs Meet Formal Finance Requirements

Traditionally, owing to a lack of tangible data to assess SME's creditworthiness, the banking sector is reluctant to lend to them and increases lending only very gradually as trust builds up. It is, however, a very lengthy and costly process, contributing to higher interest rates. Changing the situation requires helping SMEs meet formal finance requirements. It can be achieved by increasing SMEs reliability in the eyes of formal finance institutions through training but also by developing financial tools that help shift the risk away from non transparent SMEs.

Promoting SME capacity

Entrepreneurial talents and skills exist in Africa but are rarely channelled towards efficient business activity. Entrepreneurs need to be supported in developing their projects through business incubators and seed-capital programmes. These programmes notably help SMEs to produce proper accounting documents and to put bankable projects together in order to facilitate their access to finance. These initiatives require active involvement of the private sector to be successful. The AfDB has developed such a scheme in Tanzania linking business incubators with technical schools.

Supporting the emergence of SMEs is not enough to ensure their viability. Experience shows that complementary non-financial business development services (BDS) and technical support play an essential role in helping the SMEs to cope with the challenges related to their sustainability in a changing environment. The African Management Service Company (AMSCO) was established in 1989 as a joint initiative by UNDP, the AfDB and IFC with a view to supplying experienced managers and technical personnel to private companies in Africa, among which 70 per cent are SMEs. Customised training services are also offered to local managers and staff to upgrade their skills and improve performance and productivity of their company.

Developing financial instruments to mitigate the risk associated with non transparent SMEs

The lack of information on SMEs combined with the higher risks associated with lending to SMEs (related to the lack of collateral and a highly shock-prone environment) constitute serious obstacles to finance. They are, however, being overcome by the development of financial instruments tackling the information gap or shifting the risk from non transparent SMEs.

Box 7 - Franchising in South Africa

Franchising developed **in South Africa** when the country was under embargo. South Africa has been spreading the franchising technology to other countries in Southern and Eastern Africa, using its good knowledge of African markets and exporting South African brands. According to the Franchise Census conducted in 2004 by ABSA, the number of outlets operating under franchised systems in South Africa is about 23 000, mainly concentrated in retail activity and restaurants. The estimated annual turnover generated by the franchising system is 129 billion rand and its contribution to GDP 6 per cent. The franchise sector employs a total of 232 500 staff.

- *Reducing the information gap with franchising*

Some financial tools are more appropriate in an incomplete information environment to facilitate the screening process of financial institutions. Franchising, for instance, allows a transfer of a brand name and know-how that softens the lending risk. Franchised companies have a 90 per cent survival rate. The existence of a seed enterprise also saves the cost of inquiring about the activity of start-ups. Franchising is developing in southern Africa under the strong leadership of South Africa. It has also become a major element of AfDB private-sector development strategy in Africa.

- *Shifting risk to assets*

In the most classic form of loan, asset-based lending, the underlying asset of the firm is considered the primary source of repayment. The level of lending is based on the estimated liquidation value of the asset. It solves the opacity problem by replacing the evaluation of the firm's risk profile by specific evaluation of a subset of the firm's assets. It however requires a strong lending environment, with strong commercial laws and efficient registration and legal systems, which is missing in Africa, leading to very limited supply of such loans.

However, other schemes do exist, such as warehouse receipt financing in Kenya, South Africa and Zambia, in which loans are guaranteed by agricultural production held in store. This financial mechanism can be supplemented by hedging tools, as is already the case in South Africa. At the South African Futures Exchange (SAFEX), 65 per cent of the grain crop is pre-financed by commercial banks using the futures option to hedge the price risk.

Box 8 - **The Warehouse Receipts Financing Programme in Zambia**

This programme was implemented by USAID in 2002 in collaboration with the Zambian Agricultural Commodity Agency (ZACA). The farmers who benefit from a loan deliver the commodities to be stored in a bonded and insured warehouse. The credit company uses the warehouse receipts as guarantees, advancing to the borrower a specified percentage of the value of the commodity stored. Beneficiaries have accessed more than $700 000 in bank encashable warehouse receipts against their commodities stored in ZACA certified warehouses. To encourage and support local banks, the USAID funded Development Credit Authority provides a 40 per cent guarantee to the loan.

With leasing, enterprises are authorised to use a given fixed asset (real estate, equipment) without possessing its ownership in exchange for a rent. Leasing instruments reduce the need for capital investment, and transform the issue of capital investment into cash flow management to meet the periodic rents. With the lender retaining the ownership of the asset, the risk of the diversion of money is limited. It also allows an easier seizure of the asset in case of default in the payment of the rents. However, such a financial technology requires close monitoring of the enterprise and is therefore costly.

Box 9 - **Leasing Facilities for SME Finance in Uganda**

The Development Finance Company of Uganda Leasing Company Limited is a private company that provides leasing facilities to SMEs up to Ushs 500 million over a repayment period of 2 – 5 years for any asset of a durable and identifiable nature (plant, equipment, machinery, commercial vehicles and business cars). The lessor maintains full ownership of the asset throughout the lease period, with the option for the lessee to purchase the asset at the end of the lease. The insurance and maintenance remain under the responsibility of the lessee. The benefits for SMEs are the access to medium term finance, with minimum capital outlay and lower transaction costs. The scheme is also combined with fiscal benefits, and necessitates only easy budgeting thanks to fixed and equalised rentals.

- *Shifting risk to more credible "groups"*

In the absence of reliable collateral, many SME support initiatives have relied on shifting the risk associated with SME to more credible "groups", trading partners, business associations or donor/government- backed funds.

With factoring, the underlying asset (accounts receivable) is sold to the lender, shifting the title to the asset from the borrower to the lender. Factoring is interesting in countries with weak institutions, as the underlying asset is removed from the bankrupt estate. It is also appropriate in weak information environments if the receivables are associated with large, credible obligor (entities with an obligation to repay the debt). However, factoring is virtually inexistent in Africa, even in countries with advanced financial markets.

More commonly used in Africa, associative mechanisms allow mitigation of risk through mutualisation, i.e. spreading of risk over a large number of players. This helps the financial institutions in their screening process by ensuring better technical expertise of projects and by providing a moral and, in most cases, financial guarantee. Associative mechanisms, such as the "Société de caution mutuelle des entrepreneurs soudeurs de Kadiogio" in Burkina are developing in Africa. However their expansion requires SMEs to be organised. Another critical difficulty arises when all the members of the association share a common activity, and are therefore affected by similar shocks, which prevents risk mitigation.

In the absence of an organised private sector or adequate financial instruments, the most common risk-mitigation strategy pursued by governments and donors has been the development of guarantee funds. This involves the constitution of a fund to be used in case of default to pay back the lending institutions. Most countries have developed similar schemes, which involve risk sharing with the financial institutions to ensure that the latter maintain some responsibility over the selection process, as in the case of Tanzania.

Box 10 - SME Credit Guarantee Scheme in Tanzania

The SME Credit Guarantee Scheme is expected to be launched and operational in the first half of 2005. Its objective is to kick-start financing to SMEs by the banking sector, while complementing and strengthening existing banking facilities. Participating financial institutions will maintain responsibility for credit scoring, approval, monitoring and recovery. The Bank of Tanzania will initially manage the scheme. Any guarantee will be limited to 50 per cent of any loan. The size of the Fund is modest to start (Tsh 2 billion, equivalent to $2 million). Loans have a maturity of one to five years and a maximum size of about $0.2 million.

In some countries, particularly in Central Africa, experiences with guarantee funds have failed. The Fonds d'Aide et de Garantie de Crédits aux PME (Fogape) created in Cameroon in 1984 faced a liquidity crisis that practically led to its bankruptcy because of the low return rate and bad management. Similarly, the Gabon Fonds d'Aide et de Garantie (FAGA) located at the Gabonese Development bank has never functioned properly. In both cases, provision of guarantees has been synonymous with lower rigour in the choice of investment projects and lower repayment rates. In some instances, the money was diverted for personal purposes and the lack of sanctions created little incentive for repayment.

Box 11 - Setting the Proper Incentives for Financial Institutions, Public Support Institutions and Borrowers to Collaborate in Mozambique

Mozambique has accumulated some experience in the guarantee funds area, notably in developing mechanisms of punctual monitoring (carried out by independent auditing companies) that have proved crucial to ensuring high recovery rates. The authorities, supported by the donor community, are now refining the scheme, taking into account the behaviour of some banks, which have tended to take advantage of the guarantee funds and the risk-sharing agreement without reducing the interest rate or the percentage of collateral required to their clients. In response to this concern and in order to increase competition among local financial institutions, Mozambique has developed new procedures, notably by making risk sharing available only to the local financial institutions that offer the best credit conditions to the final beneficiaries of the guarantee fund.

Making the Financing Institutions more SME-Friendly

To improve SMEs' access to finance, there is a need to widen the provision of financial services by the financial sector and to increase the synergy between the various financial institutions.

Expanding and strengthening micro-finance institutions

The micro-finance institutions (MFIs) have proved efficient to a certain extent in filling the gap of SME finance. In Benin, for instance, or in Senegal, MFIs have developed beyond a purely poverty-alleviation tool, to financing economic development, through their proximity to local entrepreneurs. Their successful uptake is due to a flexible formula's being offered to small entrepreneurs, bypassing stringent regulatory and collateral requirements. One such example, Novobanco in Angola provides credit to small and medium-sized companies based on no-fees account with no minimum balance, informal guarantees (house assets and a guarantor), and a continued relationship with loan officers. Despite their adequacy to local needs, however, the MFIs remain small and fragile.

Box 12 - **Growth Possibilities of Micro-finance in Senegal**

Senegalese micro-credit differs from others *i)* by its relative concentration, as the three leading networks – CMS (*Crédit mutuel du Sénégal*), PAMECAS (*Programme d'appui aux mutuelles d'épargne et de crédit du Sénégal*) and ACEP (*Alliance de crédit pour la production*) – alone account for two-thirds of the client base, 75 per cent of deposits and 78 per cent of loans in the sector; and *ii)* by its financial soundness – the ratio of non-performing loans in the principal networks is low (2.9 per cent in March 2004).

Consequently, the large micro-finance networks appear to be in a position (and have already begun) to "grow with their customers", while benefiting from experience gained with their micro-enterprise clientele. Some of these organisations envisage creating specialist SME banks. To enable this development, the sector needs to consolidate further, and the supervision of the sector must be strengthened and legislation harmonised to allow banks to engage in micro-finance activities on the same favourable terms granted to micro-finance organisations.

- *Combining MFIs and Business Development Services (BDS) to overcome the capacity constraint*

MFIs often lack the skills to assess project proposals and develop or adopt innovative financial tools. Promoting agreements between MFIs and providers of non-financial services can ease the MFIs capacity constraint. The BDS institution can carry out the first selection of the project proposals on purely technical substance aspects and is relayed by the MFIs to assess the financial viability. In such a scheme, the MFI PRODIA of Burkina Faso signed a protocol with PAB (Projet d'Appui des Artisans Burkinabé) by which PAB would provide moral guarantees for its members seeking funds to PRODIA, based on a technical assessment of the project proposals.

Box 13 - **Banque Malienne de Solidarité (BMS)**

The BMS was established in 2002 in order to support SMEs through direct credit facilities but also indirectly through refinancing MFIs. BMS operations are closely interwoven with Malian micro-finance institutions' activities in several respects. While the government is the main shareholder of the BMS, 76 per cent of its capital is actually held by MFIs and 4 of the 9 members of its board are representatives of the major Malian micro-finance networks. As a result of this "in-built" proximity between the BMS and Malian MFIs, BMS is involved in MFI refinancing. It contributes with MFIs to the co financing of target groups of clients and it provides commercial banks with financial guarantees for their refinancing of MFIs. The partnership between MFIs and the BMS has so far been efficient and successful: MFIs are involved in more than one third of BMS' activities and no repayment failure on a credit facility made available to MFIs has been recorded so far. At the end of 2003, 29 loans had been made to MFIs for an overall amount of CFA franc 1.8 billion.

- *Ensuring MFIs' financial sustainability*

Currently, MFIs suffer from the lack of medium to long-term saving tools to transform into long-term lending. Developing and adapting long-term financial products used in other continents, such as life assurance or housing saving, may certainly help overcome this difficulty. Furthermore, the refinancing of MFIs through the formal banking sector is limited by a lack of collateral and the cost of financing. Moreover, unlike commercial banks, MFIs have no access to central bank refinancing at low cost. MFIs do not qualify, either for refinancing through venture capital as they are not formally financial institutions. These elements constitute limiting factors to SMEs' development but can be overcome by the establishment of special refinancing banks, such as the Banque Malienne de Solidarité, or by a closer collaboration with formal banks. The co-operation in Benin between PAPME (Association pour l'Appui et la Promotion des PMEs) and Bank of Africa based on a transfer of clients to the banks as their financing needs increase is a good example of co-sharing of finance for SMEs between MFIs and commercial banks. Associating informal financial organisations and formal institutions can help the former grow towards formality. A major drawback, however, is the loss of growth-oriented clients for the MFIs.

- *Reforming the MFIs regulatory framework*

Box 14 - **Regulation in Ethiopia**

In 2003 the government enacted a variety of regulatory changes that facilitated MFI funding of small enterprises, mainly by increasing the maximum loan amount and by extending the maximum loan maturity. As of mid-2004, there were 23 MFIs, which–following the regulatory changes–had extended their customer base from financing exclusively poor individuals to the financing of small enterprises. It is anticipated that some of the current MFIs will develop into fully-fledged rural banks in a couple of years, which will then also be able to finance medium-sized enterprises.

Specific regulatory frameworks may help MFIs extend their lending activities to SMEs, as in Ethiopia.

Adapting the formal banking sector to improve the availability of banking services to SMEs

- *Promoting SME-accessible banking services*

Proximity – through decentralised and smaller financial institutions – and a greater number of lending entities have proved key elements in improved access to finance for SMEs in other developing regions. In order to overcome the geographic and economic distance between traditional banks and SMEs, some countries have supported the development of smaller commercial banks (Kenya) or rural banks (Ghana), with mixed results.

Box 15 - **Rural banks in Ghana**

The government of Ghana has set up rural banks to help SMEs obtain credit. These are independent unit banks whose operations seek to bring banking facilities and credit to rural communities, and to mobilise savings. Increasingly, however, the rural banks are viewed as failing in these tasks as they tend to favour transport operators, to the exclusion of other SMEs, as transporters are in a relatively better position to make regular payments to the banks.

In a similar perspective, South Africa passed two bills in early 2005 broadening the banking system to savings and loans banks (second-tier banks) and co-operative banks (third-tier banks). These laws aim at improving access to financial services to a broader market through the development of new banking institutions that are less constrained by the standard banking regulations (the entry requirements currently prescribed by the Banks Act would be lowered). These new banking institutions are expected to improve SME's access to finance but also to facilitate the insertion of non-bank financial institutions – MFIs, village banks and co-operatives – into formal and stable banking service delivery.

In parallel, most countries are developing SME credit units within traditional commercial banks (such as the National Bank for Development and the Bank of Cairo in Egypt).

- *Supporting greater banks' outreach to SMEs*

Commercial banks need as much technical assistance and capacity building programmes as MFIs to help them deal with the specific clientele of SMEs. Some countries have adopted innovative schemes providing commercial banks with assistance and expertise in the specific realm of SME credit-risk analysis. An institution, such as the Africa Project Development Facility (an IFC project), offers financial support to commercial banks setting up credit units which are fully and exclusively dedicated to the analysis of SME credit risk and to lending operations targeted at this specific category of customers.

Inter-bank solidarity also allows mitigation of the higher risk associated with SMEs. A good example of this is the constitution of an inter-bank fund mechanism in Nigeria. Such funds could also be extended to or developed among MFIs.

Box 16 - The Nigerian *Small and Medium Industries Equity Investment Scheme* (SMIEIS)

The SMIEIS was established in 2001 by the Central Bank of Nigeria with the voluntary support and efforts of the Bankers' Committee. The Scheme requires that all banks in Nigeria set aside 10 per cent of their profit before tax annually for equity investments in small and medium enterprises. Equity investments may be in the form of fresh injection and/or conversion of existing debts owed to participating banks into equities. This arrangement eliminates the burden of interest and other charges associated with normal bank lending. The Scheme employs an innovative mechanism to ensure effectiveness through a programme in which the banks identify, guide and nurture enterprises that are financed under the scheme. However, at 31 July 2003, only N4.6 billion over the N18.6 billion set aside by banks had been invested in eligible companies.

As in the case of MFI, the transaction costs could be substantially cut through co-operation with NGOs, the latter's being in charge of the screening. The loan request brought to the banks would be made "bankable" beforehand, reducing the administrative costs for the banks. Similarly, lending to intermediaries – NGOs, associations of SMEs – which, in turn, split the sum among their members, helps lower the administrative costs. Risk-sharing mechanisms, however, are an essential element of success of such schemes.

Towards an integrated system for financing SMEs

As shown by the previous examples, close collaboration between commercial banks, micro-finance institutions, BDS and NGOs can help overcome existing constraints to SMEs' access to finance. It, however, often requires that governments and donors provide their financial support to help such schemes achieve financial sustainability. Rather than building new institutions, governments and donors now tend to rely on the existing financial system and business associations to target the SMEs. Furthermore, initiatives are more likely to be successful when well-focused and targeted, as in the case of Mozambique with flood-affected businesses.

Widening the Provision of Financial Services by Getting Money from outside the Financial Sector

Financing institutions are not the unique external source of finance for SMEs. Workers' remittances from abroad have proved to be a crucial alternative source of finance for private activity in some countries – among which Senegal and Zimbabwe certainly stand out. As equity finance develops and tax and regulations change, the solidarity networks could evolve and take the form

Box 17 - The Support Scheme of Flood-affected Businesses in Mozambique

After Mozambique was severely damaged by the floods in 2000, schemes supporting the re-establishment of the economic base of small and medium Mozambican entrepreneurs were put in place with the support of the donors. Under a particular scheme carried out by USAID, the metical equivalent of $22 million was channelled through the local banking system to flood-affected enterprises. A Programme Committee, composed of representatives of USAID and the Government of Mozambique, was established in order to allocate the funds provided by USAID. A local firm was contracted by the Programme Committee to set up a Project Management Unit (PMU) in charge of co-ordinating and executing the loan scheme and drafting an agreement with local banks. The loans to affected enterprises were provided at below market interest rates (8-10 per cent compared with the outside commercial rates of 34-36 per cent) and the commercial risk shared equally between USAID and the banks. The success of the scheme led to a lifting of the ceiling for the loan from $100 000 originally to $250 000.

of modern financial instrument such as "business angels"[23] participations, which are currently seldom used in Africa. In the short term, however, linkages (between SMEs and bigger enterprises) and clusters (among SMEs) could provide powerful fund leverage, as has been the case in both Asia and Latin America.

Subcontracting/linkages

Large companies can play an important role in promoting the SME sector by facilitating the transfer of know-how and by supporting their access to finance. Directly they can permit transfers of resources – finance or inputs. Indirectly, they can help improve SMEs access to financial institutions. However, such links are poorly developed in Africa and remain very basic, involving little leverage for value-added activities.

Until recently, the major oil companies in Central African countries had established few links with the non-oil sector, despite government encouragement to subcontract local firms. Internalising their related activities was perceived as less costly by these companies than outsourcing to immature enterprises in an instable, unfriendly business environment. In an attempt to overcome the reluctances, the World Bank has financed a project aiming at increasing the capacity of local entrepreneurs and businesses in newly oil-producing Chad to take advantage of contracting opportunities offered by the construction of the pipeline (maintenance of the pipeline, transport, food…). Training and technical assistance are offered through the local Chamber of Commerce; the scheme also includes support for local micro-finance facilities and credit for SMEs.

In contrast, subcontracting has developed rapidly since 1998 in South Africa. However, it has met with mounting scepticism as big companies appeared to be using subcontracting as a means of cutting costs and bypassing labour regulations, keeping SME subcontractors in informal and unskilled activities.

Linkages with big companies can also help SMEs benefit from trade credits. This is particularly appropriate in developing countries as trade creditors have an informational advantage over other lenders in evaluating their customers' ability to pay and they can repossess and resell goods in the event of default or withhold future supplies. This financial co-operation has proved successful in agri-business in Zambia.

Box 18 - The Outgrower Schemes in Zambia for Inputs and Fertilisers

The outgrower schemes were developed in order to foster linkages between small-scale producers and commercial agribusiness. Big commercial agribusinesses pre-finance the crop, extending credit lines to farmers to buy inputs and irrigation equipment. Highly successful, this pre-financing export facility extends credits in dollars, applying an interest rate averaging 8-10 per cent, compared to 35-40 per cent in local currency. The $1 million fund has benefited about 3000 small scale honey, horticultural and diary producers and it is already self sustaining. The next step envisaged would be to convert credits into equities.

Clustering

Inter-firm co-operation and joint action has proven a successful strategy for overcoming barriers related to smallness and fragmentation. The economic gains of clustering include economies of scale and scope as small firms specialise and engage in a division of labour. Examples from both developed and developing countries, especially in Asia, have shown that firms located in the same cluster also benefited from the proximity to sources of inputs, the availability of suitably customised business development services, the abundance of clients attracted by the cluster tradition in that industry, and the presence of a skilled labour force. Clustering promotes joint action, which in turn helps firms to deal with external shocks. This is especially important in the risky business environment prevalent in most African countries.

Clustering can also be an effective way to improve SMEs access to finance. Firms belonging to the cluster can act together in jointly seeking financing, providing

23. Private investors who invest directly in private unlisted companies, in return for an equity stake.

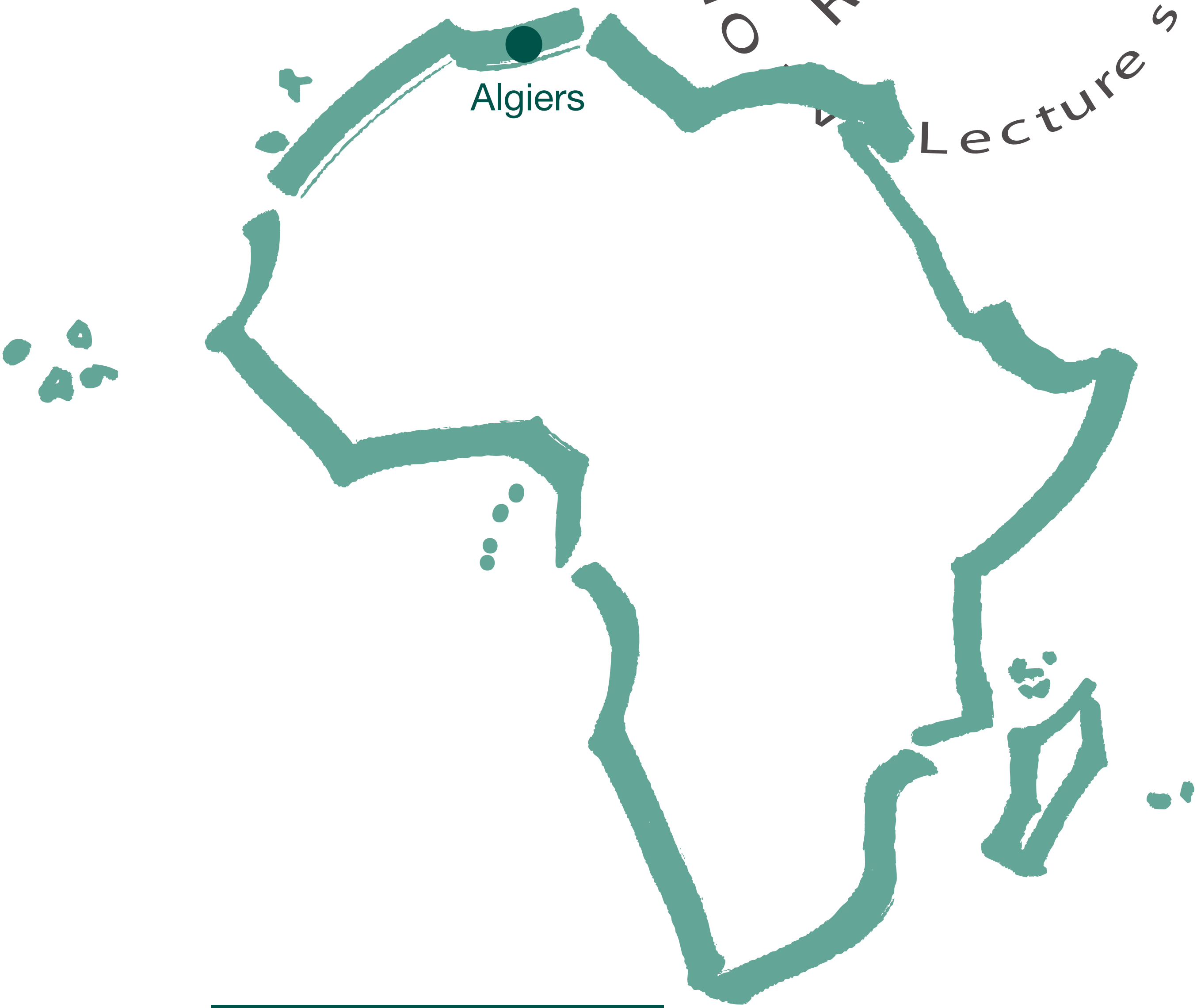
a collective guarantee, or even establishing their own financial institutions. Threat of exclusion from the network is strong enough to facilitate informal contract enforcement, therefore bypassing the shortcomings of the legal and judiciary environment. Repeated interactions and proximity with the financial institution as well as reputation effects within the cluster can considerably enhance the trust between the companies and the financial institutions, ultimately facilitating the access to credit at lower interest rates.

Clustering can also ease access to financing resources in a broader sense. Horizontal and vertical inter-firm linkages and co-operation can provide firms with access to supplier credit and to mutual insurance assistance that smooth out cash flows. It also helps to reduce transaction costs. Proximity and co-operation can also allow firms to borrow or hire from other firms pieces of equipment that they only seldom need or workers in peak periods, reducing overhead costs.

SME clustering is widely observed in India but is also strongly encouraged by Japan in neighbouring developing South Asian countries. It is, however, very little developed in Africa, where it can be found mostly in Nigeria, Kenya, South Africa, Tanzania and Zimbabwe. Most of the existing clusters are incipient and their limited development may be due to structural weaknesses hardly solved by inter-firm co-operation (such as weak institutions and highly volatile business environments).

Part Two

Algeria



key figures

• Land area, thousands of km²	2 382
• Population, thousands (2004)	32 339
• GDP per capita, $ (2003)	2 092
• Life expectancy (2000-2005)	69.7
• Illiteracy rate (2004)	29.0

GROWTH RATES OF 6.9 PER CENT in 2003 and 5.4 per cent 2004 confirm the country's economic health and stability and underpin expectation of further substantial growth of around 4.5 per cent in 2005 and 2006. Algeria has reduced its debt ratio to 24.7 per cent, rebuilt official reserves to the equivalent of nearly two years of imports, still has a budget surplus (even taking into account its FRR revenue regulation fund) and has inflation under control.

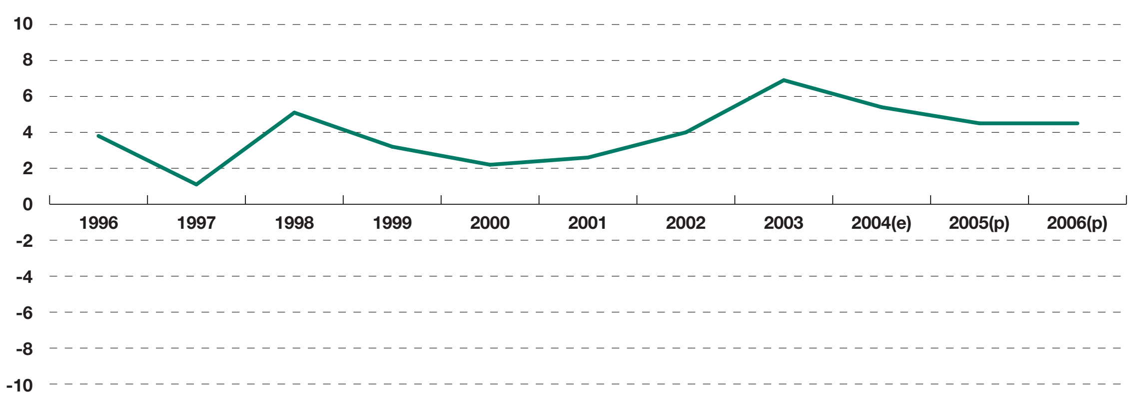
The macroeconomic situation, though still too vulnerable to oil and natural gas price fluctuations, has been maintained in the demand-driven context of the 2000-04 economic revival plan (PSRE) for much greater public investment. This has significantly increased imports, which have helped speed up growth over the past three years and cut unemployment by nearly 4 percentage points to 23.7 per cent from the 28 per cent or so it was a few years ago.

However, these results are mainly due to the oil and gas sector (currently benefiting from favourable world prices), on which the economy greatly depends for growth, its external position and especially its budget balance. This dependence, which has not lessened over the years, is partly due to slow structural adjustment of the economy, as shown by the flagging manufacturing sector and the large chunks of the economy still under state control and not performing well despite getting subsidies.

Overall performance is good, but the economy still relies too heavily on the oil and gas sector for growth.

The economy's ability to use its proclaimed liberalisation to improve living standards and increase investment to about 30 per cent of GDP depends on the government stepping up structural reform, striking the right balance between public and private sectors and making production sectors more flexible and competitive.

Figure 1 - **Real GDP Growth**

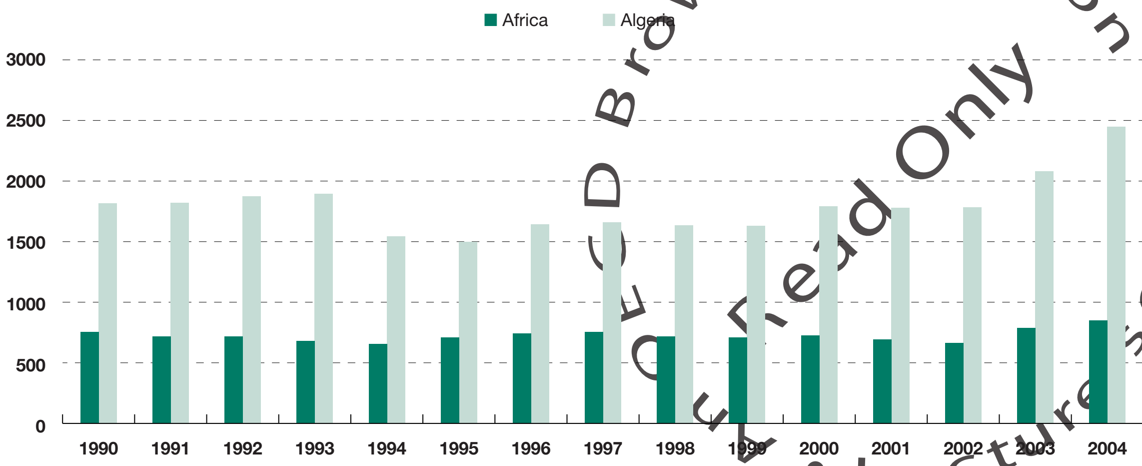


Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Recent Economic Developments

After several years of only slight growth, the economy began to take off in 2001 and this progress has been confirmed and expanded. Growth accelerated to 6.9 per cent in 2003, 1.8 percentage points more than the record in 1998. As well as the big contribution of oil and gas, other sectors, notably construction and services, played their part and non-oil/gas GDP increased 6.1 per cent in 2003. Overall growth in 2004 was slightly less at 5.4 per cent (5 per cent non-oil/gas) and the government expected it to be 4.5 per cent in 2005 and 2006.

Figure 2 - **GDP Per Capita in Algeria and in Africa** (current $)



Source: IMF.

Adequate rainfall produced exceptional harvests in 2003 and the agricultural sector grew 17 per cent (after shrinking 1.3 per cent in 2002), mainly because of good sector policies and financial management of state farmland since the national agricultural development plan (PNDA) was launched in 2000. Cereal production more than doubled in 2003 to nearly 42.4 million quintals (from 20.2 million in 2002). Non-cereal vegetable output, which is less erratic because of expanding irrigation, grew much more slowly (4 per cent). Livestock production continued to advance, showing a 7 per cent increase (5 per cent in 2002).

Agriculture was nearly 10 per cent of GDP in 2003 and its share of overall growth increased by 1.8 per cent after falling 0.1 per cent in 2002. The sector's growth is expected to slow in 2004 to 2.2 per cent, but should recover to 4.1 per cent in 2005.

The oil/gas sector strengthened its domination of the economy in 2003 with growth of 8.8 per cent, its best performance in a decade, thanks to new fields coming into production. The crude oil branch and liquefied natural gas (LNG) branches showed 33 per cent and 5.3 per cent growth respectively in a context of high world prices. This boosted the sector contribution to overall growth by 2.2 percentage points (+1.1 in 2002).

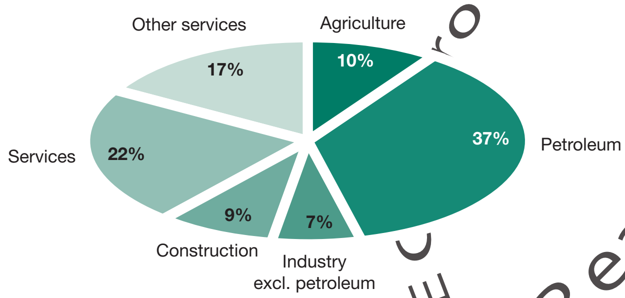
Oil production was 1.4 million barrels/day in 2004 and is expected to rise to 1.5 million in 2005. The national oil company Sonatrach was Africa's biggest firm in 2004, with a turnover of $31.5 billion ($18.6 billion in 2003), which was 43.8 per cent of Algeria's GDP and 5 per cent of that of the whole continent. Its exports were worth $28.5 billion (159 million oil-equivalent tonnes).

Natural gas production rose 5 per cent in 2004, to 144.3 billion cubic metres (137.6 billion in 2003), mainly because production started mid-year at the Saharan field of In Salah, which has an annual production capacity of 9 billion cubic metres. LNG production fell 15 per cent, to 40.7 million cubic metres (from 47.6 million in 2003), however, due to the destruction, in a January 2004 explosion, of the Skikda complex in eastern Algeria.

The government expects the oil/gas sector's growth to slow in 2004, to 6.4 per cent, and to 4.4 per cent in 2005. The sector accounts for 36.5 per cent of GDP, 65 per cent of government revenue and 97 per cent of export earnings, but only employs 3 per cent of the workforce. So with nationwide unemployment high, economic diversification is urgent.

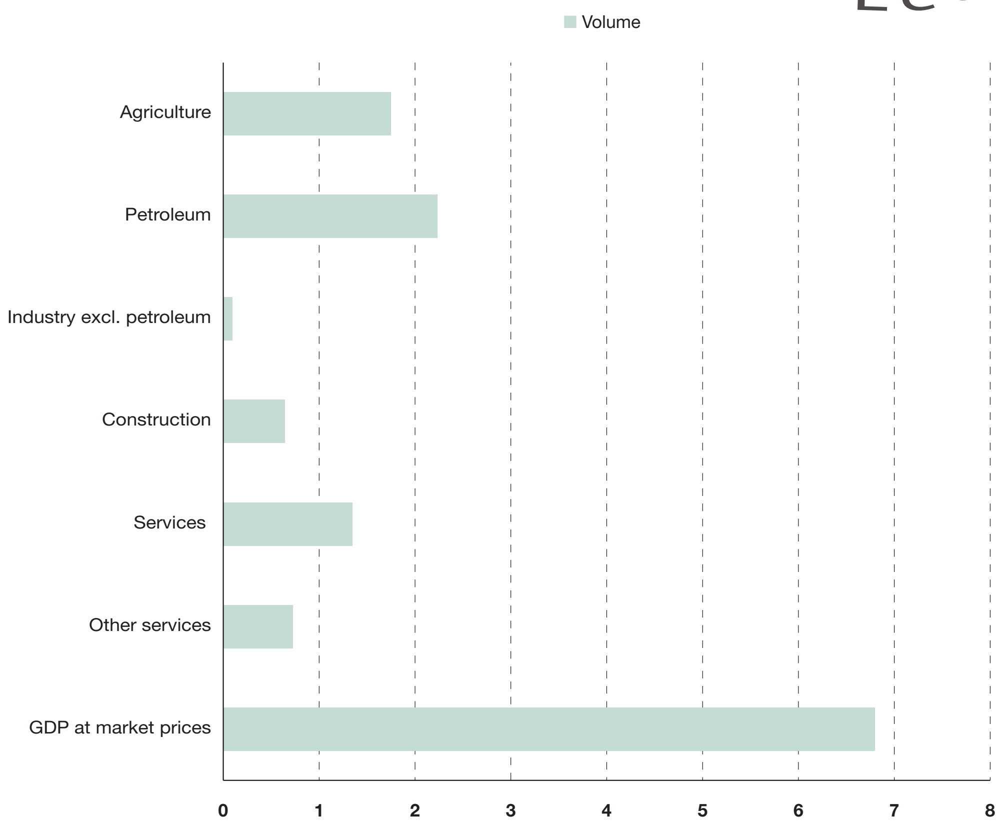
The construction sector performed quite strongly again in 2003, growing 5.8 per cent, even if less than the 8.2 per cent of 2002. This slowdown was due partly to a shortage of suitably-sized firms with the right skills, according to government officials. This meant

Figure 3 - **GDP by Sector in 2003** (in percentage)



Source: Authors' estimates based on Ministry of Finance and Office National des Statistiques data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (in percentage)



Source: Authors' estimates based on Office National des Statistiques data.

the sector did not fully benefit from investment programmes such as the repair of infrastructures damaged by the 21 May 2003 earthquake, ongoing infrastructure and PSRE housing projects and the extension of oil-related public works. The sector should grow about 5.4 per cent in 2004 and contribute 0.6 per cent of overall growth.

Algerian industry, apart from these two sectors, is hampered by many largely inefficient and unprofitable state-owned firms whose wage bill exceeds their turnover. The non-oil/gas and non-construction industrial sector registered a 1.7 per cent fall in growth in 2003 to 1.2 per cent, mostly due to structural problems in manufacturing industry. But it grew 3.2 per cent in 2004 due to private sector efforts and accounted for 0.2 per cent of overall growth. It should expand by 2.4 per cent in 2005 and again supply 0.2 per cent of total growth.

Manufacturing has slumped by 50 per cent over the past 15 years, causing a significant loss of industrial activity despite strenuous financial efforts on the part of the government. All state-owned manufacturing did less business in 2003 – 20.6 per cent in agro-food, 10.4 per cent in chemicals, rubber and plastics, 7.6 per cent in construction materials and 5.3 per cent in the wood, cork and paper industries. But some sectors grew, notably steel, metal, mechanical and electrical industries (ISMME) (9.1 per cent), energy (6.6 per cent) and to a lesser extent mines and quarries (0.7 per cent.

The government wants to tackle the situation by boosting and speeding up the modernisation of production to adapt it to the demands of growing economic liberalisation and by upgrading management skills and capacity. This should make manufacturing more competitive and, above all, make the rather unadventurous private sector more dynamic. Privately controlled industry grew 2.9 per cent in 2003. This was down certainly from 6.6 per cent in 2002 but still showed a potential that could be better used. Private sector activity in 2003 grew in construction materials and ceramics (2.4 per cent), chemicals (2.2) and agro-food (1.7).

The services sector has grown more than 5 per cent a year since 2000 and expanded 7.3 per cent in 2004, mainly due to transport development, itself boosted by growth in commerce and distribution resulting from much stronger import growth. Growth should fall back slightly, to 6.5 per cent, in 2005, reducing its contribution to overall growth from 1.7 per cent in 2004 to 1.5 per cent in 2005.

The growth of consumption overall increased 0.9 per cent in 2003 to 4 per cent and its contribution to

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**25.1**	**27.0**	**30.4**	**29.8**	**28.8**	**28.6**	**28.8**
Public	6.4	8.4	10.1	11.0	10.8	11.1	11.5
Private	18.7	18.6	20.3	18.8	18.0	17.6	17.4
Consumption	**68.6**	**58.4**	**59.6**	**55.2**	**51.4**	**48.0**	**49.0**
Public	15.8	14.7	15.3	14.1	13.3	12.3	12.2
Private	52.8	43.6	44.2	41.1	38.1	35.6	36.8
External sector	**6.3**	**14.6**	**10.0**	**15.0**	**19.8**	**23.4**	**22.2**
Exports	30.2	36.6	35.6	39.0	42.2	45.3	43.2
Imports	-23.9	-22.0	-25.6	-23.9	-22.4	-22.0	-21.0

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

overall economic growth improved 0.5 per cent. Consumption is expected to increase 5.1 per cent in 2004 and 3.8 per cent in 2005 due to increases in private consumption (5.3 per cent in 2004 and 3.9 per cent in 2005) and public consumption (4.6 per cent in 2004 and 3.3 per cent in 2005). But overall consumption fell to 51.4 per cent of GDP in 2004 (from 55.2 per cent in 2003) and is expected to sink further (to 48 per cent) in 2005.

Gross capital formation rose 6.5 per cent in 2003 and the investment rate was one of the highest in the region (29.8 per cent in 2003 and 28.8 in 2004). Investment should hold up in 2005 (28.6 per cent) and 2006 (28.8 per cent) and enable the country to base its growth on solid foundations, as long as the public-private balance improves and infrastructure projects are implemented more strictly and efficiently.

Macroeconomic Policies

Fiscal and Monetary Policy

Budget policy has been an important government tool in recent years, giving form to decisions about the use of oil/gas revenue, supporting economic growth, meeting growing social demands and preserving macroeconomic stability.

From 2001 to 2004, the government implemented a $7 billion economic revival plan (PSRE) to boost growth and jobs. It set up a revenue regulation fund (FRR) in 2000 to enable the budget to be adapted to oil price fluctuations and drew up a medium-term expenditure framework (MTEF) independent of oil/gas revenue. It reformed taxation to gradually reduce the government's dependence on oil/gas revenue and divert spending to education and health with the aim of preparing the way for economic liberalisation by giving people more skills and qualifications.

Budget revenue was up nearly 12 per cent year-on-year in 2004 at 2 201 billion dinars and represented 37.1 per cent of GDP. The increase was mostly from oil/gas revenue, which rose more than 16 per cent to 1 569 billion dinars and accounted for more than 71 per cent of all government revenue. Supplementary budget laws are based on a $19 a barrel oil price, so the FRR has plenty of funds. It received, for example, 448.9 billion dinars in 2003 after the average oil price increased $25.20 to $28.90 and exports rose to 24.9 per cent of GDP from 23.2 per cent in 2002. However, non-FRR revenue fell 3.5 per cent year-on-year in 2003.

Direct tax revenue rose 7.9 per cent in 2004 (11.4 per cent in 2003) and tax from goods and services by 15.2 per cent (4.7 per cent in 2003) but customs revenue was down 5.6 per cent (after increasing 11.1 per cent in 2003) and registration and stamp duty returns by 10.5 per cent (7.2 per cent in 2003). Budget revenue is expected to be 38.3 per cent of GDP in 2005 and 36.7 per cent in 2006.

Budgeted expenditure in 2004 was 1 878 billion dinars, up 7.1 per cent year-on-year, but its share of GDP fell to 31.8 per cent (33.1 per cent in 2003). The higher spending was matched by a shift (resulting from implementation of the PSRE and PNDA) in the respective shares of current and capital spending in total expenditure. Capital spending grew steadily from 8.4 per cent of GDP in 2001, to 10.2 per cent in 2002 and 10.8 per cent in 2003. It should stay at 10.6 per cent in 2004, reflecting the government's wish to give more weight to capital spending as a means of boosting the economy and standard of living.

Current spending declined slightly to 21 per cent of GDP in 2004 (22.6 per cent in 2003). Overall expenditure should stabilise in 2005 and 2006 at about 30 per cent of GDP, due to reduced current spending

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**32.2**	**34.9**	**36.0**	**38.2**	**37.1**	**38.3**	**36.7**
Tax revenue	11.0	9.0	10.4	9.7	9.4	9.3	9.3
Oil revenue	20.8	24.0	23.1	27.6	26.0	27.2	25.5
Total expenditure and net lending[a]	**29.2**	**31.5**	**35.8**	**33.1**	**31.8**	**29.8**	**30.2**
Current expenditure	22.4	23.2	24.9	22.6	21.0	19.0	18.9
Excluding interest	*18.9*	*19.7*	*21.8*	*20.4*	*19.2*	*17.8*	*17.9*
Wages and salaries	8.7	7.6	7.8	7.4	7.0	6.4	6.3
Interest	3.5	3.5	3.1	2.3	1.8	1.2	1.1
Capital expenditure	6.8	8.4	10.2	10.8	10.6	10.8	11.2
Primary balance	**6.4**	**6.9**	**3.3**	**7.4**	**7.4**	**9.7**	**7.5**
Overall balance	**2.9**	**3.4**	**0.2**	**5.1**	**5.3**	**8.5**	**6.5**

a. Only major items are reported.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

and wages.

Interest on public debt has fallen from 3.5 per cent of GDP in 2001 to 1.8 per cent in 2004 and is expected to shrink to 1.2 and 1.1 per cent respectively in 2005 and 2006.

Revenue increased faster than expenditure and the 2004 budget surplus was 5.3 per cent of GDP and should rise to 8.5 per cent in 2005 before dropping to 6.5 per cent in 2006. The government has been trying to reduce the debt since 2001.

Against a background of consolidation of net external assets and budget-based economic stimulation, the Bank of Algeria continued with a cautious monetary policy in 2004, seeking to control money supply and bank liquidity so as to minimise the risk of inflation without discouraging private investment. The main challenge will be to offset the considerable effect of the banks' excess liquidity. It had mopped up 250 billion dinars in cash on the interbank market by the end of December 2003, reduced its liquidities absorption rate from 0.75 per cent in June 2003 and to 0.25 per cent in September 2003, and upped its reserves requirement from 4.25 to 6.25 per cent.

Excess liquidity increased over the year however because of growing net external assets and due to banks accumulating money faster than they use it. The liquidity ratio of M2 (total money supply) to GDP rose from 65.3 to 65.5 per cent between 2003 and 2004. The need to continue tightly controlling bank liquidity should prevent growth of non-performing bank loans. M2 increased 15.8 per cent in 2004, mainly because of a 26.3 per cent rise in cash and bank deposits (M1) due more to an increase in fiduciary money, treasury deposits and post office cheque accounts than in demand deposits in banks.

These developments showed that net external assets, which totalled, 3 018.6 billion dinars in 2004 (2 342.7 billion in 2003), were the main source of money creation by the banking system. This is confirmed by the 14.3 per cent drop in net internal assets, due to domestic credit falling 13.4 per cent. Net loans to the government fell 77 per cent while loans to the economy grew 6 per cent.

Inflation was 4 per cent in 2004, slightly up on 2003's 2.6 per cent, and is expected to fall to 3.6 per cent in 2005 and 3.2 per cent in 2006.

The Bank of Algeria intervened on the exchange market to stabilise the dinar after its real value fell considerably in 2002 and 2003 (9 per cent a year on average), but the gap between the official and parallel markets remains large at over 25 per cent. The dinar is only convertible for trade but firms with a convertible dinar export account (Cedac) are not allowed to hold more than 10 per cent of it in foreign currency.

External Position

Goods exports, at $33.3 billion in 2004 ($24.5 billion in 2003), increased 36.1 per cent as oil/gas exports rose 35.3 per cent, helped by both higher oil prices and higher export volumes. Oil/gas exports generated more than 97 per cent of the country's foreign currency earnings. Non-oil/gas exports increased 79.3 per cent in 2004 after dropping 21.6 per cent in 2003 but still only accounted for 2.5 per cent of total exports.

The highly oil-price-dependent export structure shows how much remains to be done, as the country prepares for activation of its association agreement with the European Union (EU) and membership of the World Trade Organisation (WTO), to diversify its production sector and make it more competitive. The necessary transition will involve paying greater attention to the euro-dinar exchange rate and speeding up reform to encourage the private sector as a way of revitalising, or rather reviving, the manufacturing sector.

Imports, at $17.6 billion, were up 32.1 per cent in 2004 but their share of GDP fell. The increase was mainly due to an increase in imports of capital goods corresponding to investment growth and to lower import tariffs. The country's main trading partner, the EU, takes 55 per cent of exports and supplies 57 per cent of imports.

Algeria had a $15.7 billion trade surplus in 2004 (up from $11.6 billion in 2003 and $6.7 billion in

2002). Exports should rise 20.1 per cent in 2005 and imports 8.8 per cent, resulting in the trade and current account surpluses being increased to 25.1 and 16.7 per cent of GDP respectively. The trend should be confirmed in 2006 when the trade surplus is expected to stand at 23.8 per cent of GDP.

However, the 2004 trade surplus was offset by increased deficits in services ($1.94 billion) and factor income ($3.2 billion) in the current account, which nevertheless turned in a very respectable performance with a surplus of nearly $12.73 billion, representing 15.4 per cent of GDP (13.2 in 2003).

The capital account deficit more than doubled in 2004, however, to reach $3.04 billion ($1.37 billion in 2003), due to the slowing of foreign direct investment, which came only to $0.39 billion (down from $0.62 billion in 2003).

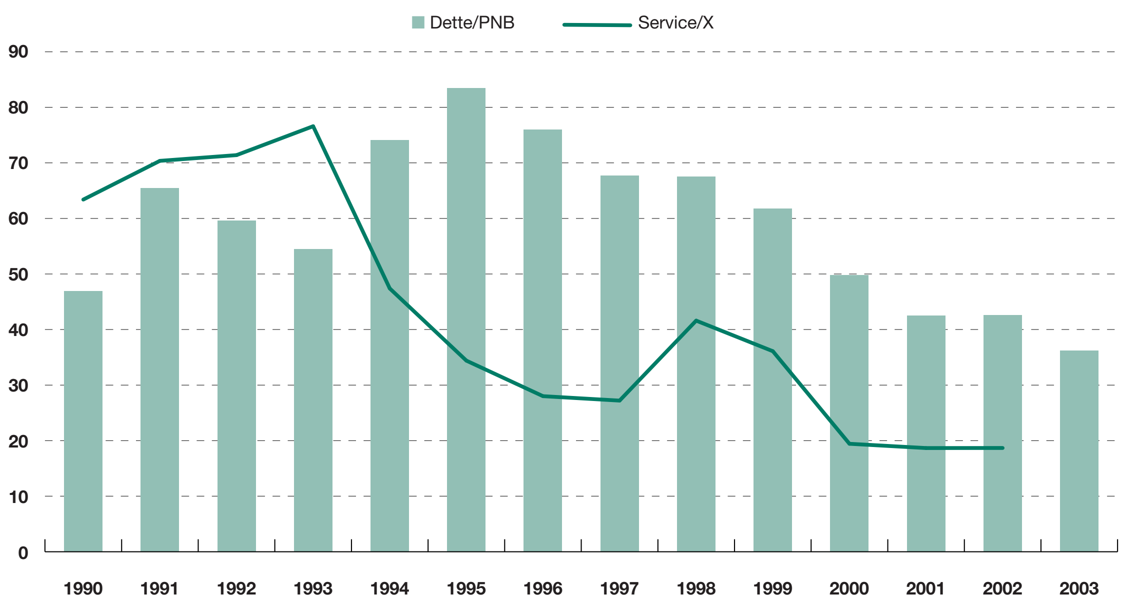
Overall, the 2004 balance of payments surplus totalled nearly $9.7 billion, enabling the government to continue the efforts it has been making since 1999 to build up foreign exchange reserves. These came to $42.3 billion in 2004 ($32.9 billion at the end of

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	8.8	17.5	12.0	16.7	21.5	25.1	23.8
Exports of goods (f.o.b.)	28.2	34.8	33.5	36.8	40.2	43.5	41.4
Imports of goods (f.o.b.)	-19.4	-17.3	-21.5	-20.0	-18.7	-18.4	-17.6
Services	-3.0	-2.8	-2.1	-2.0			
Factor income	-5.3	-3.1	-4.0	-4.1			
Current transfers	1.9	1.2	1.9	2.6			
Current account balance	**2.4**	**12.9**	**7.8**	**13.2**			

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

2003), equivalent to two years of imports.

Medium and long-term external debt was $20.4 billion in 2004 and continued to fall in relation to GDP. It fell from 36.2 per cent of GDP in 2003 to 24.7 per cent in 2004, while the ratio of debt service to exports improved 1.8 percentage points.

Structural Issues

Structural reforms to reduce the government's role in the distribution of goods and services, improve financial and banking facilities and make the legal system more effective are vital to improve business conditions. Government activity is still weighed down by complicated bureaucracy, widespread sinecures and chronic corruption.

The small and medium-term enterprises/industries (SME/SMI) sector has grown from scratch, as there was no networking in Algeria and no industrial policy for SMEs, even though a ministry of SME/SMIs has existed since 1992. The growth of the sector meets a genuine economic need, especially for jobs to reduce the high 23.7 per cent unemployment rate. Many incentives are now being put in place. The country's informal economy is very vigorous, including in the financial sector.

Formally organised and regulated micro-credit is very new to Algeria and has only officially existed since a January 2004 decree broadly defined such activity and the procedures for its creation. These facilities are destined to contribute to the creation of firms producing goods and services, including in homes, by funding the purchase of equipment and raw materials for start-up purposes or for the purchase of raw materials more generally. They are offered to those with no income or only small irregular earnings with the aim of helping them to integrate socially and economically through the creation of businesses needing investment of between 50 000 and 400 000 dinars. These people have to be 18 or older, have a fixed address, possess some know-how in the business they are proposing and not be getting any similar aid.

The contribution required to get such loans depends on the borrower's qualifications, the total start-up cost and the place where the business is located. It is 5 per cent of the total cost of setting up a business through the acquisition of equipment and raw materials and 3 per cent when the applicant has a diploma or other recognised certificate or when a business is in the southern or Hauts Plateaux regions. For the second kind of loan, for buying raw materials, the minimum personal contribution is 10 per cent of the total cost but cannot be more than 30 000 dinars.

Bank loans can supplement these contributions with the help of the national micro-credit support fund FNSM but are subject to normal bank lending rules. Bank loans can be up to 95 per cent of the total cost of the business (between 50 000 and 100 000 dinars) and up to 97 per cent when the applicant has a diploma or the business is in a special area. Funding is only up to 70 per cent when the cost is between 100 000 and 400 000 dinars.

Interest relief on micro-credit loans by banks and financial institutions applies to 80 per cent of the normal loan rate for the business in question and 90 per cent for businesses in the south and the Hauts Plateaux. To ensure project viability, borrowers can have free technical help and interest-free government loans, again depending on the applicant's qualifications, total cost and location. Micro-credit borrowers seeking bank loans have to join and pay dues to the FGMM micro-credit mutual guarantee fund set up in 2004.

The national micro-credit management agency ANGEM was set up in January 2004 under the authority of the prime minister and is monitored day-to-day by the minister of labour. It has a policy council composed of representatives of sector bodies and institutions and a committee that monitors implementation of the council's decisions. ANGEM provides supports and advice for borrowers as they start up their businesses, dispenses interest-free loans and checks that the business is complying with its original terms and conditions. It complements other facilities set up since 1996, mainly by the national youth employment agency ANSEJ.

In 2003, the regulatory framework for banks was changed to allow them to expand into helping young business people in the production sector. Bank funding of such projects was raised to up to 70 per cent of total investment. Loan periods were extended to up to seven years and micro-businesses were made eligible for operating loans needed for production cycles.

A total of 293 800 micro-enterprise projects had been registered by 30 September 2004, including 252 involving expansion of existing production capacity. ANSEJ reckons they could create about 820 000 new jobs. Agriculture is the most popular sector for projects (25.5 per cent), followed by services (25 per cent), trades and crafts (11 per cent) and industry (8.3 per cent). The extension projects are mainly in trades and crafts (30 per cent), services (22 per cent) and industry (13 per cent).

Out of 236 800 eligible projects, 123 600 (52 per cent) resulted in loan applications to the banks, of which 64,000 were successful. Another 17 700 applications are pending and 42 000 have been rejected. Loans totalling 77 333 billion dinars were granted towards investments totalling 118 066 billion dinars, giving a funding rate of 65 per cent. Of the 64 000 successful applications, 52 500 were funded by ANSEJ for a total investment of 91.1 billion dinars, comprising 61.2 billion dinars in bank loans, 16.6 billion dinars in interest-free loans from the national youth employment fund FNSEJ and 13.3 billion dinars of applicants' own money.

The Bank of Algeria and the state banking commission increased supervision of banks and financial institutions in 2003 to help them meet the demands of economic restructuring. This helped them to cope with the collapse of two private banks, El Khalifa and the BCIA. Two decrees tightened conditions for setting up in the financial sector and revised the rules governing activity and control. The bankruptcies nevertheless damaged the financial sector, mainly because savers and investors lost confidence in it.

The government is still aware of the need to hasten banking reform so the sector can play its financial intermediary role on a secure footing. The reform aims to go beyond the gap that has developed between private banks and state banks, which are crippled by a large number of bad loans and are unused to competition, while the commercial banks look for immediate profit, with harmful effects on the system's stability. The recapitalised state banks' accounts have been sorted out but they still hold 92.7 per cent of all bank assets and borrowing terms for potential investors have become much too strict.

New facilities to help investors have been created as part of continuing efforts towards financial innovation. They include an investment guarantee fund (FGI), with a capital of 30 billion dinars supplied by the government, the banks and financial institutions, which is destined to provide better cover against the risk of insolvency and bankruptcy.

The government wants to speed up modernisation of bank procedures, introduce computerised payments and interbank transfers, revitalise the capital market and set up specialised financial institutions so as to establish a new relationship between businesses and banks based on profitability and prudential rules.

The government continued in 2004 to develop the country's infrastructures as a means of encouraging private sector initiative. A €40 billion economic growth support plan (PSCE) was launched in August 2004. Work on roads includes major projects such as the coast road, the east-west motorway, the Hauts Plateaux by-pass, north-south freeways, the trans-Sahara, the opening of new and repaired roads aimed at ending the isolation of about 700 000 people and improving traffic movement in major towns and cities.

The new Houari Boumediene airport in Algiers and those in Toughourt, Béchar and Constantine are being completed and others are being built in the Hauts Plateaux and the south. Strengthening seaport facilities through which nearly 90 per cent of the country's trade passes is a priority. Reorganisation of the national shipping company CNAN is being speeded up and plans are afoot to upgrade, better manage and increase the capacity of ports, especially that of Algiers. The PSCE also provides for the building of two high-speed railway lines and completion the Algiers subway system, which has been under construction for the past nearly 30 years.

Great efforts are needed to modernise telecommunications. Only 30 per cent of households had access to a phone in 2003 and there was a waiting list of 700 000 for a fixed line. Algérie Télécoms, a publicly-traded company created out of the posts and telecommunications sector reorganisation begun in 2000, plans to add half a million lines with the help of the Ericsson group.

Algérie Télécoms and Orascom Télécoms Algérie shared the mobile phone market until the arrival of a Kuwaiti group, National Mobile Telecommunications, which bought the third GSM licence in December 2003 for $421 million. The mobile phone market is estimated at 2 million lines in the short term, 6 million medium-term and 12 million long-term.

The government has revived privatisation in a bid to speed up infrastructure upgrading and that of the economy generally. A total of 111 state-owned firms were privatised in 2004 but 1 283 firms still remain to be divested. About 300 should be disposed of in 2005. The privatisations have created some 2 400 new jobs and raised about 18 billion dinars (€187 million). They have also involved planned investment totalling 24.72 billion dinars (€257 million), not including 8.2 billion dinars (€85 million) of public debt taken on by buyers. The government has said it does not want to privatise "strategic" or "sovereign" firms in areas such as oil/gas, electricity, gas and railways.

A new legal framework installed in 2001 has made privatisation easier by introducing greater transparency and simpler procedures. The privatisation strategy is defined by the state holdings council (CPE), with assistance from the ministry of state holdings, and is implemented by 28 holdings management companies (SGP), set up to manage the equity of public firms up for privatisation.

A first reform plan in the oil/gas sector in 1999 aimed to streamline exploration and production and convert Sonatrach from a state company into a publicly-traded one. The firm's development plans in China, Peru, Libya and Jordan would need part of the firm to be sold to the private sector. The plan was rejected in 2004 after opposition by the country's main trade union, the UGTA, which staged a two-day strike in February 2003 that was followed 98 per cent nationwide.

The plan should have a better chance of going through in spring 2005 since the union has reached agreement that 20 per cent of firm's shares will be reserved for national interests (its workers, the general public via the stock exchange and institutional investors).

Sonatrach invested $3.9 billion in 2004 and plans to invest $5.1 billion in 2005 to develop natural gas deposits, drill 65 wells and carry out prospection in Africa and Latin America. The firm is due to open a 747 km trans-Mediterranean gas pipeline (Medgaz) between Algeria and Spain in July 2005. With capacity to carry 8-10 billion cubic metres of gas a year, it should earn Algeria an annual $500 million from 2007.

Political and Social Context

A row broke out in 2003 between President Abdelaziz Bouteflika and Prime Minister Ali Benflis. Connected with the early start of the presidential election campaign, it resulted in a battle for control of the ruling party, the National Liberation Front (FLN), which ended with Benflis' replacement by Ahmed Ouyahia in May 2003. Bouteflika was re-elected with 85 per cent of the vote on 8 April 2004. He pledged to continue democratisation, strengthen the rule of law and respect for human rights and consolidate civil peace. Security improved noticeably but labour unrest persisted in 2004, notably in the education and health sectors.

The country needs to strengthen its social sector achievements, reflected in a 3.5 per cent increase in GDP per capita between 2001 and 2004 and a fall in the proportion of the population under the poverty line from 14.1 per cent in 1995 to 13 per cent in 2002. Unemployment remains very high, despite dropping from 27.3 per cent of the active population in 2001 to

23.7 per cent in 2003, and affects urban (23.9 per cent) and rural areas (23.4 per cent) fairly equally. Young people are worst hit, with 43.9 per cent in the 20-24 age group out of work.

The government increased efforts in 2004 to boost living standards, making use, notably, of the different provisions of the PSRE to try to ease social tensions and improve national unity and stability. But social services continue to fall short of targets in terms of quality and regional coverage.

Reorganisation of the state electricity firm Sonelgaz has resulted in the creation of decentralised subsidiaries and the construction of new installations in several regions, including Algiers, Skikda and Oran. These developments should further boost national electricity coverage, which increased from 90 per cent in 2002 to 93 per cent in 2003.

Water supply problems and nationwide rationing are caused by lack of co-ordination among the many parties involved, bad management of the network, non-payment of bills and non-observance of regulations. Old-fashioned production methods and lack of trained staff, which lead to extensive leakage and high running and maintenance costs, are also to blame. The national water distribution agency, ADE, has been strengthened and its action plan is starting to produce results. About 85 per cent of Algerians had water in 2004 (95 per cent in urban areas and 70 per cent in the countryside). Sewage systems greatly need improving.

The housing ministry estimates that there is a national shortage of 2 million homes, but only 67 164 units were begun in 2003 and 74 071 delivered, markedly fewer than in 2002, especially in low-cost housing. A partnership with the World Bank plans to improve the situation and the PSCE provides for the construction of a million low-cost units in 2005.

The country reached a new demographic milestone in 2000, when the gross birth rate fell below 20 per 1 000 (to 19.2) and Algeria officially became a medium-fertility country. The synthetic fertility index fell, from 4 children per woman in the early 1990s to 2.4 in 2002 (2.1 urban and 2.7 rural). The average age of marriage rose from 27.7 to 33 for men between 1987 and 2002 and from 23.7 to 29.6 for women, due to the spread of modern contraception methods, women working and better education.

The health-care system has made clear progress, as shown both by the main disease indicators and by improved staffing, equipment and infrastructure. The government drew up a serious health programme in 2001 and pledged massive investment. Budget money for health was nearly 65 per cent higher in 2004 than in 1999 and focused on rebuilding infrastructure, building new installations and upgrading equipment.

This substantially improved access to health care and coverage of the population's health care needs. As a result, the gross mortality rate fell to 4.41 per 1 000 in 2002 and average life expectancy rose from 67.3 years in the early 1990s to 73.9 in 2003. Infant mortality, at 41.2 per 1 000, is quite low for Africa, which averaged 79.3 per 1 000 in 2004 and where some countries exceed 100.

Much remains to be done to improve the finances of public health bodies and find better ways to fund the system, expand the private health sector and improve staffing. Care quality also needs to improve to cope with new ailments arising from the demographic changes.

Educational reform has focused on teacher training, reforming curricula and general reorganisation of the sector. It has strengthened initial training for new teachers and set up a national training and refresher programme for working teachers and a range of measures to improve their status. Curricula have been revised, notably for language teaching, textbook content and the criteria used for choosing between the different disciplines. Science has been emphasised and new information and communication technology is being introduced as a teaching tool and a means of access to knowledge.

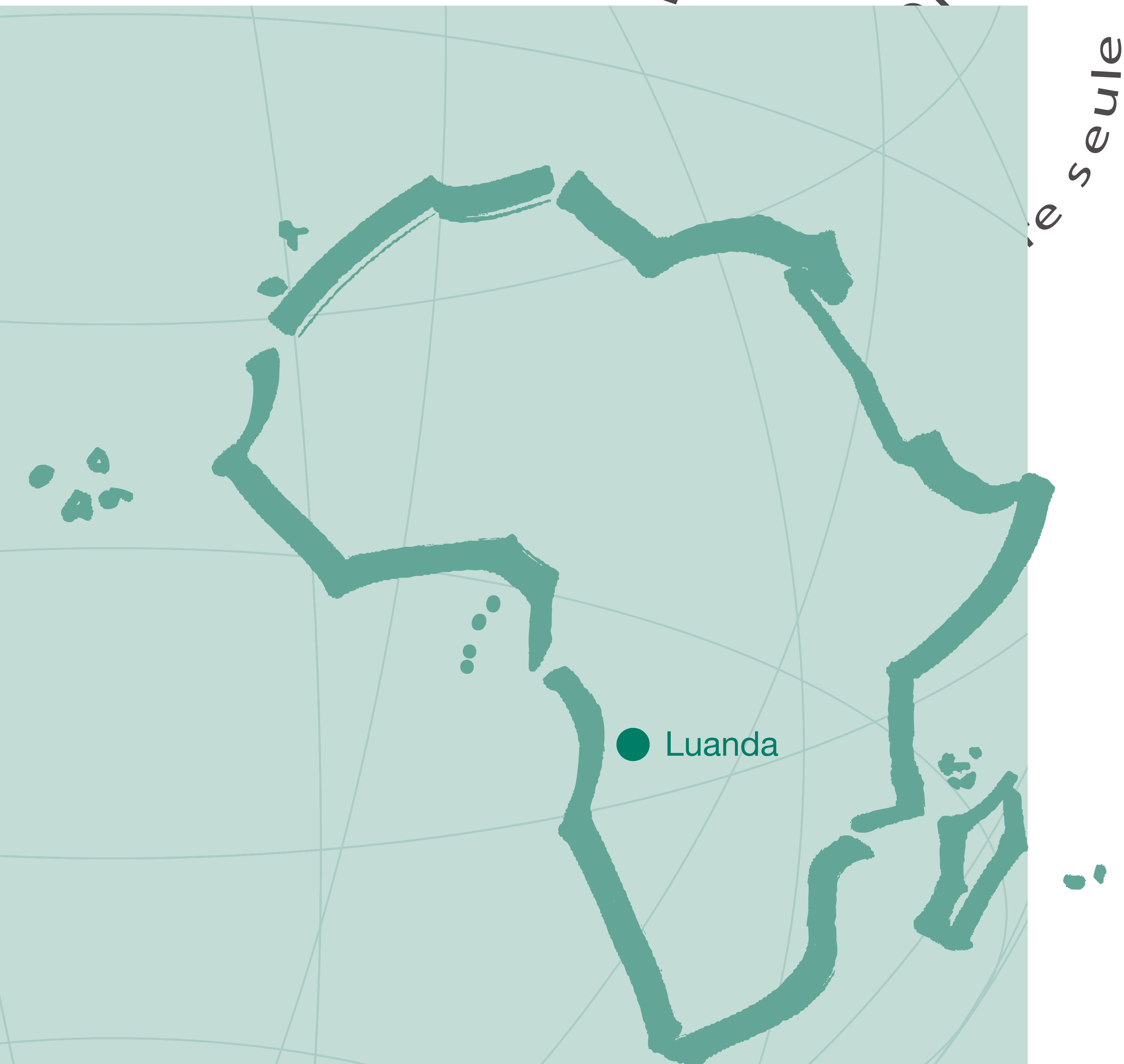
Overall reform of the system provides for: the expansion of pre-school education for five year olds; the organisation of compulsory basic education in two phases (one for primary education which will be reduced in the medium-term from six to five years and a second four year phase for intermediate education); introduction of a post-compulsory cycle comprising secondary and technological education and ending with the baccalaureate; and technical and professional education ending with a technical certificate or professional baccalaureate("bac"). Higher education has been reorganised into an ordinary university degree ("bac" + 3 years), a master's degree ("bac" + 5 years) and a doctorate ("bac" + 8 years).

A national education and training council (CNEF) and national education monitoring centre (ONE) have been set up to monitor and assess the reforms. The basic education reform introducing new subjects (science and technology, music and drawing) in primary schools, English from the age of nine and the fourth year in the intermediate cycle, came into effect in the 2003/04 school year. In 2004/05, French was introduced in the second year of primary school and the first stage of the higher education reform (new version of ordinary degree and doctorate) was implemented. The master's degree will not be introduced until the first new ordinary degrees are awarded in 2008.

The fresh resources brought in with the reform have resulted in reductions in the number of children per teacher and per class, which fell respectively from 38 to 28 and from 36 to 27 in the first two phases of basic education between 2001 and 2003. During this time, 71 new secondary schools were built that will bring classroom size down to about 19 pupils, one of the lowest in the region.

Illiteracy in the 15+ population fell to 31 per cent in 2003 (from 47 per cent in 1990), while school enrolment increased to 95 per cent in primary education and 62 per cent in secondary in 2003.

Angola



key figures

- Land area, thousands of km² 1 247
- Population, thousands (2004) 14 078
- GDP per capita, $ (2003) 1 015
- Life expectancy (2000-2005) 40.1
- Illiteracy rate (2004) ...

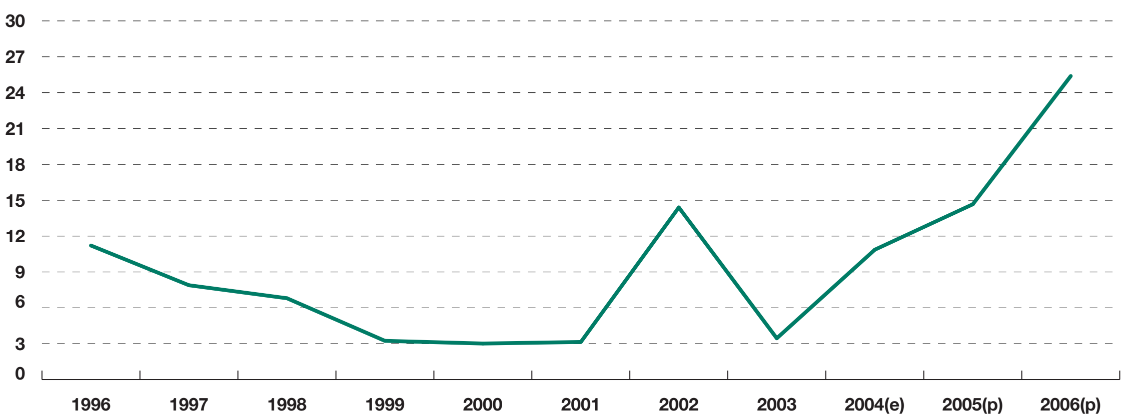
ANGOLA HAS BEEN LARGELY AT PEACE since a cease-fire between the armed forces and the rebels was signed in April 2002, putting an end to more than 25 years of almost uninterrupted civil war. The country now faces the daunting task of channelling its huge resource endowment into reconstruction of its infrastructure and into poverty reduction activities. Diamonds and, especially, offshore oil dominate the national economy, their combined resources accounting for almost the entirety of hard currency and fiscal revenues. These sectors, however, create very few linkages to the rest of the economy. Agriculture and manufacturing are still suffering from the legacy of the civil war – wrecked infrastructure, lack of physical and financial capital, poor governance, the pervasive presence of land mines in some regions – and the need to resettle 4 million people displaced by the fighting.

Despite rising international oil prices, real GDP growth in 2003 was disappointing at about 3.5 per cent, owing to declining production of mature oil fields[1]. Growth gained momentum in 2004, reaching 11 per cent, as new oil fields came on stream. The continued rise in oil production is expected to raise growth to about 15 per cent in 2005 and about 25 per cent in 2006. In past episodes of oil-boosted growth, the authorities showed some complacency in their policy stance at the expense of macroeconomic stabilisation and better governance, as shown by the abandonment of two IMF staff-monitored programmes (SMPs). This time around, however, the policy stance is tighter, with the fight against inflation taking a prominent role as Angola strives to reach agreement with the IMF on the terms of a third SMP. Inflation fell below 35 per cent in 2004, for the first time in several decades, and the local currency, the kwanza, has remained relatively stable against the dollar.

Huge resources endowments must be channelled into reconstruction of infrastructure and poverty reduction.

As in other post-conflict environments, the challenges ahead are enormous and require a strong commitment from the government that can be supported by the international community. The latter is mainly concerned by the lack of transparency in oil revenue management, recourse to extra-budgetary expenses and oil-backed commercial loans, and the

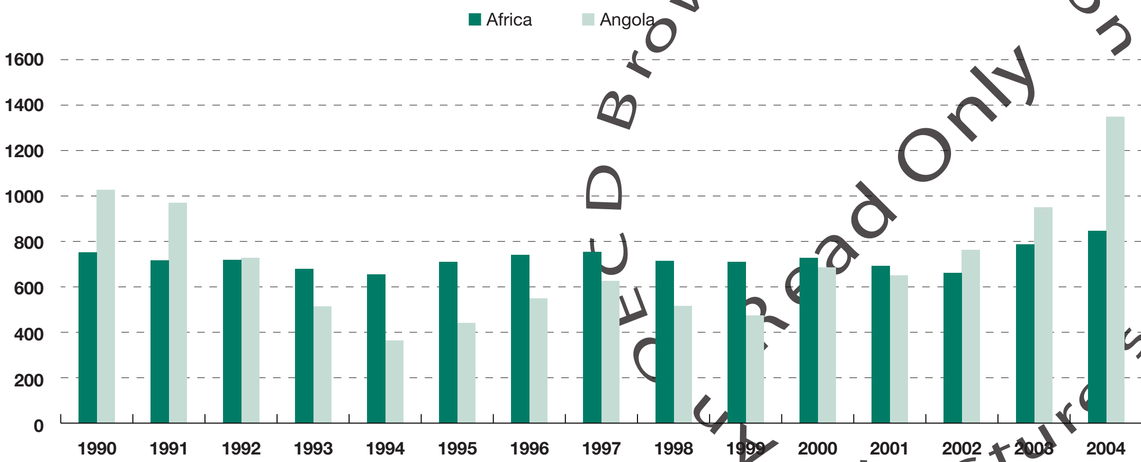
Figure 1 - **Real GDP Growth**



Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

1. Statistics are abysmally poor in terms of both availability and quality, which hinders proper analysis of the economy, the establishment of priorities among competing needs and the implementation of appropriate measures.

Figure 2 - **GDP Per Capita in Angola and in Africa** (current $)



Source: IMF.

resulting external debt burden. The effort to reduce inflation, while necessary, has a considerable social cost, in view of the lack of official safety nets and the disintegration of the social fabric caused by the civil war. In this context, the finalisation of the Poverty Reduction Strategy launched in 2000 is expected to provide much-needed clear policy goals and a macroeconomic framework consistent with their achievement.

Recent Economic Developments

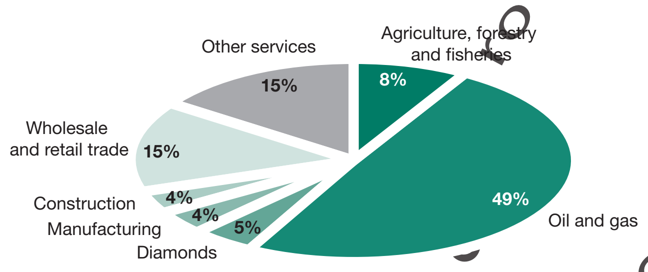
The Angolan economy remains heavily dependent on the oil sector, a capital-intensive sector with very few linkages to other sectors of the economy and little impact on employment. In the aftermath of the civil war, diversification of the economy is hampered by inadequate physical infrastructure, poor governance and corruption.

Since large-scale production started in the late 1970s, oil has shaped the Angolan economy. Offshore fields, mostly in the Congo river basin opposite the Cabinda enclave, contain an estimated 12 billion barrels. Insulated from the civil war, the petroleum sector has continued to grow, its production doubling between 1990 and 2003 to almost 1 million barrels a day. In 2003, oil accounted for more than 45 per cent of GDP, 75 per cent of government revenues and 90 per cent of exports. The state-owned enterprise Sonangol retains sole ownership of the fields and participates in oil extraction and operation, accounting for 35 per cent of Angola's oil sales. The company has entered into production-sharing agreements with major western oil companies, led by ChevronTexaco and Total, which account respectively for 61 per cent and 27 per cent of overall production.

Oil exploration activity and discoveries in Angola have intensified with the recent renewed interest in the geopolitical importance of the Gulf of Guinea as a source of oil supply. With the Xicomba field coming on stream in 2004, daily production reached 1 million barrels for the first time and is expected to exceed 1.3 million in 2005 and 1.6 million in 2006. In this context, the role of Sonangol as franchisee and operator has raised concern over economic inefficiencies and conflicts of interest. The oil sector analysis released in May 2004 revealed the opacity still surrounding the company's financial statements and its management of state subsidies.

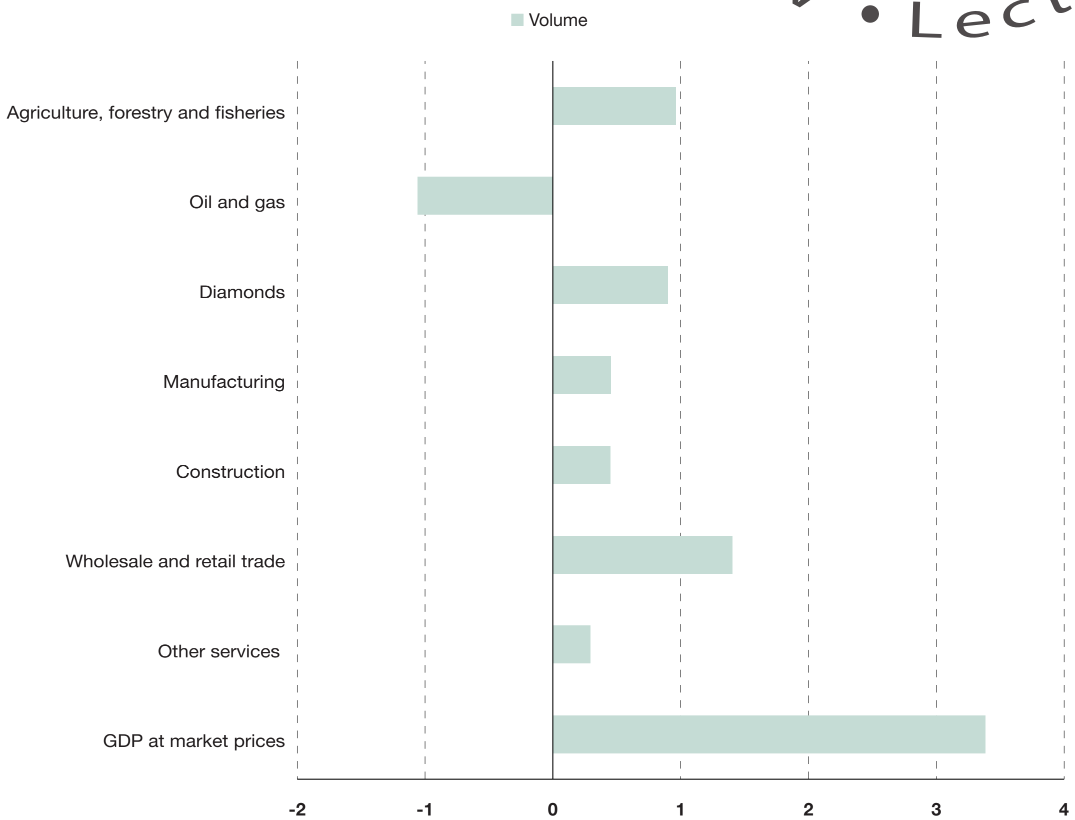
Diamond mining is the second-largest source of export revenues (about 10 per cent of total exports). As in other countries, official data on the diamond trade are notoriously imprecise because of smuggling. Moreover, most reserves were located in provinces under the control of the National Front for the Liberation of Angola (UNITA) and hence were not accounted for in

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on National Institute of Statistics data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on National Institute of Statistics data.

government statistics. The country's only remaining kimberlite mine is the Catoca mine in Lunda Sul province, the world's fourth-largest diamond mine, a joint venture between Endiama, the Russian firm Alrosa, the Brazilian company Odebrecht and Israeli-Russian businessman Lev Leviev. There are also extensive alluvial projects, both formal and informal.

The domestic non-mining economy has recorded sluggish growth and only recently recovered the level prevailing in the early 1990s. Land under cultivation amounts to roughly 3 per cent of total arable land, which constant rainfall makes ideally suited for export crops such as coffee (of which Angola was once the world's fourth-largest producer), sisal, tobacco, cotton, palm, sugar, citrus fruits and sesame. Agriculture was severely affected by the critical security situation, as farmers found it increasingly difficult to buy seeds, fertilisers and other inputs and to market their output to urban consumers. Farming has also been constrained by the presence of mines throughout the country, a major hindrance that has been removed only partially since the end of the hostilities. Once self-sufficient in major staple crops (maize, cassava, sorghum), Angola has developed a huge food deficit, requiring humanitarian assistance through the World Food Programme. The end of hostilities and the perception that food aid is crowding out domestic suppliers may lead donors to discontinue such support by end-2005.

The livestock situation is slightly better, as cattle were not eliminated during the war.

The country also boasted a thriving manufacturing sector before the civil war, accounting for 18 per cent of GDP in 1973, although it may have been inefficient due to high tariff protection. Its GDP share has now fallen to less than 4 per cent, mainly in light industries such as food processing, beverages and textiles. Heavy industries either operate well under maximum capacity (cement and petroleum refining) or are inoperative (steel). Infrastructure is still being rehabilitated at a modest pace, with the emphasis mostly on roads (including a new toll bridge over the Kwanza river);

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**34.5**	**39.5**	**35.6**	**40.2**	**33.4**	**30.2**	**29.2**
Public	13.1	3.6	3.3	6.3	5.2	4.9	5.1
Private	21.4	35.9	32.4	33.9	28.1	25.3	24.1
Consumption	**52.4**	**76.4**	**66.3**	**64.2**	**54.9**	**48.8**	**47.5**
Public	33.3	32.8	30.8	30.8	26.1	22.4	20.7
Private	19.0	43.6	35.4	33.4	28.8	26.4	26.8
External sector	**13.1**	**-15.9**	**-1.9**	**-4.4**	**11.8**	**21.0**	**23.3**
Exports	82.1	73.5	79.1	73.9	73.4	71.6	66.9
Imports	-69.0	-89.3	-81.0	-78.3	-61.6	-50.6	-43.6

Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

this activity, together with a mini-boom in residential buildings in Luanda, has sustained the construction sector, which expanded by 12.6 per cent in 2003. In the services sector, the communications sub-sector grew by 35 per cent in the first half of 2004, reflecting the launch of a second cellular phone operator and increased traffic volumes.

Table 1 highlights the Angolan economy's dependence on natural resource exports and its reliance on imports for most consumer goods, a natural consequence of the poor state of domestic industry. In 2005 and 2006, export and import volumes are expected to grow in tandem with an increase in private investment – almost entirely foreign – concentrated in minerals. Although still at a very low level, public investment doubled as a percentage of GDP from 2002 and 2003, spurred by poverty alleviation programmes and reconstruction efforts in infrastructure.

Macroeconomic Policies

Fiscal and Monetary Policy

Throughout its civil war, which ended in 2002, Angola recorded annual inflation rates exceeding 100 per cent. Even after 1987, when the country abandoned central planning, embraced economic liberalisation and launched a series of anti-inflationary programmes, inflation remained stubbornly high. Price stabilisation was undermined by large fiscal imbalances, together with sizeable central bank operating deficits. In a context of buoyant world prices and rising extraction, oil revenues and expensive oil-backed loans from international commercial banks were used to finance permanent expenditure increases (such as a large army and civil service payroll, arms purchases and consumer subsidies) that would be difficult to reverse during periods of falling oil prices and/or when oil reserves are depleted. These policies led to large non-oil fiscal deficits and low international reserves. Additionally, the policy anchor constituted by the Poverty Reduction Strategy Paper (PRSP) was lacking in Angola; although launched five years ago, the PRSP process has yet to be finalised.

Following the introduction of strong stabilisation measures in September 2003, inflation fell to 77 per cent by end-2003 and 31 per cent by end-2004. In 2003, the fiscal deficit remained relatively high, at 7.9 per cent of GDP. For the first time, however, fiscal operations included most off-budget expenditures, including off-budget transfers to the military, the quasi-fiscal operations carried out by Sonangol on behalf of the government and the central bank's operating deficit, which amounted to some 1 per cent of GDP. The fiscal deficit was financed by substantial recourse to external loans and grants and the use of signature oil bonuses.

In 2004, the fiscal deficit was reduced to 3.5 per cent of GDP as a result of higher oil revenues and measures to improve budget execution procedures and controls, while revenues from international trade taxes failed to rise despite the transfer of customs management in Luanda to Crown Agents.

The budget for 2005 is predicated on continued efforts to contain and monitor expenditure, notably through the phasing out of price subsidies for petrol and public utilities and a substantial cut in non-wage current expenditures. The phasing out of the oil subsidy began in May and November 2004 with sizeable increases in the retail prices of petroleum products, and it is planned to reduce this subsidy from 4.5 per cent of GDP in 2004 to 1.1 per cent in 2005. Despite substantial increases in oil production in 2005 and 2006, oil revenue increases are expected to be modest, owing to the amortisation of substantial development and operating costs associated with the exploitation of new deep-water oil fields.

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**46.5**	**47.1**	**40.5**	**37.3**	**35.9**	**35.7**	**33.7**
Tax revenue	3.8	7.3	7.9	7.8	6.8	6.2	6.1
Oil revenue	40.8	36.9	31.1	28.2	28.7	28.8	27.2
Total expenditure and net lending[a]	**57.5**	**49.4**	**49.8**	**45.1**	**39.4**	**33.9**	**31.9**
Current expenditure	52.9	36	37	36.7	32.6	27.9	25.6
Excluding Interest	*41.3*	*30.7*	*33.6*	*34.9*	*30.2*	*26*	*24.1*
Wages and salaries	8.8	8.1	11.3	12.5	11.7	9.2	8.4
Interest	11.5	5.2	3.3	1.8	2.4	1.9	1.6
Capital expenditure	4.9	6.3	7.1	7.7	6.2	5.8	6
Primary balance	**0.6**	**2.9**	**-6**	**-6.1**	**-1.1**	**3.7**	**3.4**
Overall balance	**-11.0**	**-2.3**	**-9.3**	**-7.8**	**-3.5**	**1.8**	**1.8**

a. Only major items are reported.

Source: IMF and Ministry of Finance data; estimates (e) and projections (p) based on authors' calculations.

The stabilisation measures implemented since 2003 succeeded in holding inflation to an estimated average of 40 per cent in 2004, and inflation is expected to fall further to 31 per cent in 2005 and 26 per cent in 2006. If the process is to be sustainable, however, it will require prudent management of the non-oil fiscal deficit (defined as the overall fiscal deficit excluding oil revenues – a key indicator for assessing fiscal sustainability in natural resource-rich countries) and saving of the windfall profits from high oil prices in the form of financial wealth for future generations. The alternative course, i.e. the continuation of large non-oil fiscal imbalances, would shift the cost of adjustment to future generations, which will have to live with depleting oil reserves. In addition, budgetary allocations for health and education have been kept at a very low level (in the 2005 budget, they account respectively for 7.3 and 4.6 per cent of total expenditures, compared to 12.5 and 7.9 per cent devoted to defence and security). Finally, despite some improvements, a great deal more progress is needed to achieve transparency concerning oil revenues. At present, poor monitoring and control of public expenditure make it difficult to arrive at a comprehensive assessment of the country's fiscal situation, and hence to win the support of the international community (including the signing of an SMP).

In 2003, the kwanza depreciated by 37 per cent against the US dollar, yielding a sizeable real appreciation which hampered growth prospects in the non-oil economy. The stabilisation plan, implemented since September 2003, has included exchange rate unification, the launch of weekly sales of foreign exchange, enhanced control over commercial banks' liquidity (through new legal reserve requirements and regulations on commercial banks' foreign exchange positions) and closer policy co-ordination between the Treasury and the National Bank of Angola (BNA). BNA data on foreign exchange transactions are shrouded in opacity, however, as imports financed by lines of credit (from Brazil, China and Israel) are not included. This hampers understanding of the extent of foreign currency intervention needed to sustain the nominal exchange rate.

External Position

Since 1999, Angola has substantially reduced its import duties and rationalised their structure, cutting the top tariff rate from 110 to 35 per cent and again to 30 per cent in recent months, and the number of tariffs to only five *ad valorem* tariff bands ranging from 2 to 30 per cent. This simplified tariff structure substantially reduces the distortions caused by protection, although the tariff exemption list is still extensive and offers plenty of loopholes for avoiding import tariffs. Customs regulations remain opaque and often confusing after decades of incremental changes and unco-ordinated updates. A new customs law is being drafted, but no date has been scheduled for its implementation. Angola is not heavily reliant on taxes on international trade (these taxes accounted for only 5.5 per cent of total revenue in 2002), which will facilitate its future engagement in regional and multilateral initiatives.

Angola formally acceded to the SADC Trade Protocol in March 2003 and is currently preparing a schedule for its implementation. The bulk of SADC trade liberalisation measures are scheduled to be introduced by 2008, and member states are carrying out a mid-term review of the Trade Protocol to that effect – a process in which Angola is expected to play an important role as a member of the steering committee.

Angola became eligible to benefit from the United States' African Growth and Opportunity Act (AGOA) only in December 2003, but it has been the leading beneficiary of the Generalised System of Preferences (GSP) since 1999. Over 93 per cent of Angolan products eligible for GSP, predominantly oil and petroleum products, enter duty-free under the programme.

Oil exploitation strongly influences the trade balance. Oil exports have accounted for 90 per cent of total exports over the past five years and are estimated to have risen by 40 per cent in 2004. A second product recording strong export growth is diamonds.

The United States is the largest export destination (more than 40 per cent of exports over the past five years), followed by China. European Union countries are the single largest source of imports, accounting for roughly half of Angola's external purchases. Processed and fresh food products, in particular, are mostly imported from Portugal and South Africa respectively, while equipment and machinery are the main import item from the United States.

High oil prices coupled with increased oil production boosted exports in 2004, resulting in a large trade surplus. Continuing growth in crude oil production is expected to enhance export volumes further in 2005 and 2006. This will lead in turn to an increase in imports of capital goods.

Three related phenomena – the discovery of new oil

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	46.6	37.5	42.3	29.2	38.6	43.3	42.9
Exports of goods (f.o.b.)	77.5	73.1	77.2	68.8	70.0	69.2	65.1
Imports of goods (f.o.b.)	-31.0	-35.6	-34.9	-39.6	-31.4	-25.9	-22.2
Services	-33.7	-37.1	-28.9	-22.6			
Factor income	-20.8	-17.5	-15.1	-12.5			
Current transfers	3.4	1.0	0.3	0.7			
Current account balance	**-4.4**	**-16.0**	**-1.4**	**-5.2**			

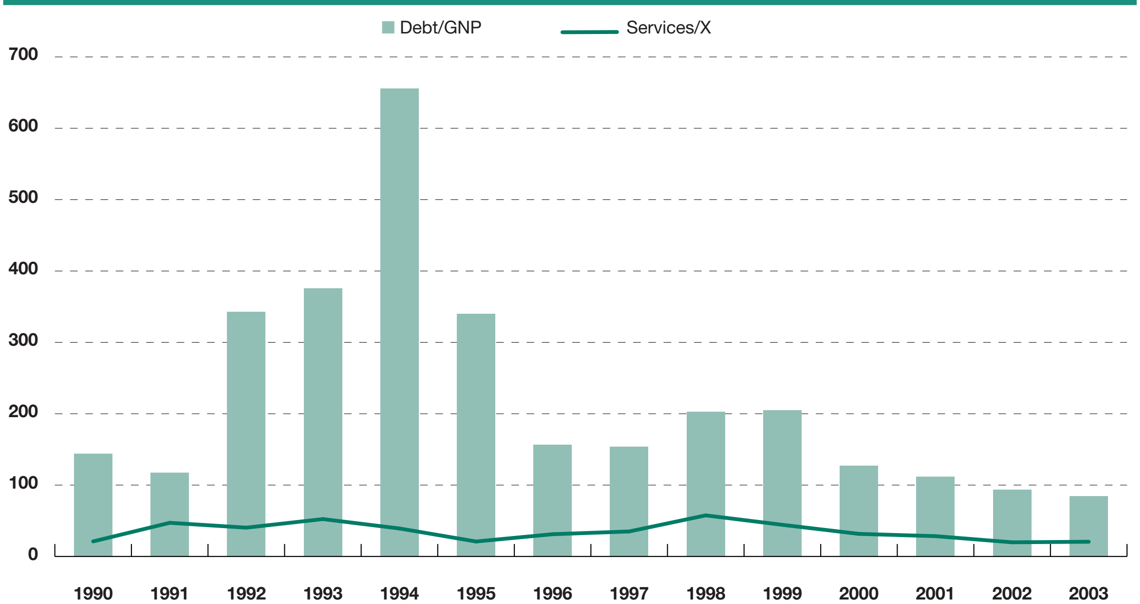
Source: IMF and National Bank of Angola data; estimates (e) and projections (p) based on authors' calculations.

fields, the increasing cost-effectiveness of deep-water exploration in a context of high oil prices and the strategic interest of American business in the energy potential of the South Atlantic – are driving FDI activity. ChevronTexaco, in particular, has earmarked $11 billion for investment over the next five years. Despite their positive contribution to GDP and exports, oil projects have very high import intensity and very few linkages with local business. Although the number of backward and forward linkages has started to grow – foreign companies have *ad hoc* programmes to increase local content – the integration between domestic and foreign businesses remains limited to very low-skilled activities such as catering and cleaning services.

The rest of the economy attracts very little FDI. Investors perceive the business climate as being very risky, even though special incentives and tax exemptions have been granted to make trade liberalisation less uniform across sectors. To add value to the local diamond industry, in April 2003 the government approved a plan to end the monopoly of Ascorp (a joint venture between the state and some foreign investors, including the Leviev Group) over diamond purchasing, and the Leviev Group is currently building a $3 million cutting factory.

The authorities have not disclosed external debt data since 2001. At end-2004, according to IMF

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

estimates, Angola's debt amounted to $9.6 billion (including arrears and overdue interest), the equivalent of 50 per cent of GDP or 120 per cent of net exports (excluding oil-related expenses). While the latter ratio is below the threshold for the Heavily Indebted Poor Countries (HIPC) initiative, the debt problem lies in the external debt structure and heavy reliance on costly short-term oil-backed loans that heighten the country's external vulnerability. While the government is on schedule with respect to its obligations *vis-à-vis* multilateral creditors, commercial banks and non-Paris Club bilateral creditors, including Brazil and Portugal, Angola is in arrears with most of the Paris Club creditors.

Structural Issues

The legacy of more than two decades of war and of a single-party political system, combined with heavy reliance on oil and diamonds, has deeply affected the quality of governance and made its improvement the key challenge for Angola.

Since 1988, new laws have been issued to regulate economic activities; organise the activities of the financial markets, mining and fisheries; formalise the first wave of privatisations; and introduce incentives for foreign investment in the non-oil sectors. Nonetheless, with mixed results from privatisation and limited progress in addressing the vulnerability of the financial system, these measures have not succeeded in giving investors the right incentives to engage in risk-taking and job-creating activities. In particular, business relationships have been characterised by rent-seeking behaviour, and many investors have found it exceedingly difficult to compete with a small number of businesses having strong political influence and connections (the so-called *empresarios de confiança*).

In tandem with efforts to stabilise the macroeconomic environment, new initiatives have been launched to foster private sector development. These include a new investment law that provides equal treatment to foreign and Angolan firms (with few exceptions); the new commercial code enacted in early 2004 to replace the 1888 commercial code and the 1901 law on limited-liability companies; and the establishment of the National Private Investment Agency (ANIP), a one-stop registration office for companies. Additional provisions will be required, however, before the commercial code can be effectively implemented, and the investment law is vague on profits repatriation and fails to provide strong legal safeguards to protect foreign investors. A Land Tenure Law was passed in 2004 with the aim of clarifying property rights and customary tenure. Major problems remain, however, since in many cases colonial registries have been destroyed and registration of transfers of ownership, occupation and concessions is in disarray as ministerial jurisdictions are badly defined and often overlapping.

Investments in the petroleum, diamond and financial sectors continue to be governed by specific legislation. In the case of oil, a controversial draft law was presented to foreign investors in mid-2004. The law would require international oil companies to channel their export receipts through the domestic banking system. Foreign investors claim that national banks are unprepared to accommodate massive foreign currency flows efficiently. Moreover, they argue that specific provisions regulating employment of Angolan nationals and profits repatriation amount to a breach of contractual obligations. The draft competition law has not yet been transmitted to Parliament.

State-owned enterprises play an important role in the economy, and the privatisation process was suspended in 2001, following concerns regarding the status and success of the process. Many state industrial and manufacturing enterprises record substantial losses, which have in many cases depleted working capital. Under the burden of a destitute population that fled the civil war, provision of basic public services (electricity and water in particular) is very deficient: network connectivity does not exceed 20 per cent of the population and cuts are extremely frequent. Although hydropower potential is large, generation technology is outdated and little investment has been made since the early 1990s to maintain power plants and the transmission and distribution networks. Some firms, such as Angola Telecom, the railways and the national airline TAAG, have engaged in corporate restructuring with a view to attracting foreign interest. In Luanda, selected public services, such as urban transport and waste management, are already operating under concession. A second mobile service provider has been operational since mid-2003, its market share now approaching 55 per cent. Progress in attracting private investment is hampered, however, by the lack of judicial safeguards, including independent regulators.

According to the 2002 census carried out by the National Institute of Statistics, the non-farm private sector comprises some 19 000 enterprises and provides employment to 341 000 people. The majority of these firms are located in the Luanda area and are active in trade and personal services. These figures underestimate the size of the private sector, as a substantial share of economic activity is undertaken in the informal sector, for which no reliable estimate exists. In an environment long characterised by the fragility of successive peace agreements, high inflation, a volatile exchange rate and low returns on kwanza deposits, over 70 per cent of deposits and 70 per cent of loans are denominated in foreign currency. This limits access to credit, for smaller firms especially. Collateral requirements are stringent but proper land titling is almost non-existent. Ownership remains a prerogative of the state, and user rights, being uncertain, cannot be used as collateral, which seriously limits lending to agriculture. Commercial banks show a marked preference for large firms having relatively long track records and strong connections to the establishment.

In 2000, the authorities set up a credit institution (*Fundo de Desenvolvimento Economico e Social* – FDES) to channel part of the country's large oil revenues to support investment in the private sector. FDES targets mostly small and medium-sized enterprises with loans ranging from $10 000 to $500 000, channelled through commercial banks. According to the original plan, FDES was supposed to receive $150 million from oil "bonuses" in 2000, but as of mid-2004, only $30 million had been disbursed. FDES has financed 170 projects, mainly in transport and fishing, with an average size of about $20 000, generating more than 4 500 jobs. Its activity has been hindered by scarcity of financial resources and the weaknesses of the financial system through which it operates. The intermediating banks

Micro-finance Banks Offer Flexible Formulas to Bypass the Red Tape

Novobanco, a micro-finance bank also active in other Southern African countries, has developed financial instruments and a system of credit lines that bypass the red tape hampering access to finance for established businesses. In the three months since its opening in Luanda in September 2004, the bank had already extended more than 120 credit lines in a total amount of $600 000 (the average loan was for $5 000, maturing in 3-5 years, at a monthly interest rate of 4 per cent), almost entirely to clients operating in the trade sector. Such a successful uptake, well in excess of the company's expectations, was made possible by the flexible formula offered to small entrepreneurs, which includes a no-fees account with no minimum balance, informal guarantees (house assets and a guarantor) and an ongoing relationship with loan officers. A network of such officers is responsible for assessing portfolio quality and monitoring clients, for which they are paid performance-related salaries. The USAID-financed scheme lacks, however, a technical assistance component, which is considered one of the main requirements for small business development.

Recently, other successful initiatives have combined lines of credit to small businesses with training and technical assistance. In particular, a local bank, Banco Sol, originally involved in group lending, has gradually started financing individual businesses from its traditional clientele. On the strength of its well-established relationships with clients and its wide geographic coverage, the bank has implemented a successful approach, requiring informal collateral and relying on international NGOs for monitoring and assistance to the client.

did not provide adequate monitoring of the projects financed, owing to poor credit information and analysis. Loans were secured by mortgages on fixed assets and collateral.

Other initiatives to satisfy the pent-up demand for financial services have been developed only recently, as the political situation has stabilised. These include creating the proper regulatory framework for micro-credit, building the necessary human competencies, setting up credit bureaux and business development services to reduce informational gaps, developing financial instruments that are more attuned to the needs of the Angolan business community, and reaching hitherto poorly serviced parts of the country. Implementation is in the hands of a variety of public and private partners, including government agencies, donors and international organisations, and oil companies, which are contractually required to devote part of their profits to fund corporate social responsibility activities. As described in the box on previous page, the results have been encouraging. This proves the existence of pent-up demand for financial services on the part of medium-sized businesses that are usually not served by commercial banks and have grown beyond the reach of micro-finance.

Political and Social Context

Angola entered a new era on 4 April 2002, six weeks after the death of UNITA leader Jonas Savimbi, when a cease-fire was signed between the armed forces and the rebels. At the time, UNITA was largely in retreat after suffering a serious military defeat at the hands of the better armed and organised government forces, and was politically isolated on both the international and domestic fronts. Since then, the new leadership of UNITA has been struggling to manage the difficult transition from a fragmented movement to a united political party.

The authorities have been faced with considerable challenges, and progress has been uneven. On the one hand, a modicum of peace and democracy has returned, as shown by the emergence of an independent press and civil society organisations. On the other, the needs of the internally displaced, who numbered 4 million at the end of the war, and of the former UNITA insurgents have not been adequately met, under the combined effect of regional and ethnic inequalities and an inadequate governmental response. More than 300 000 people are estimated to be still living outside their area of origin, between 5 and 7 million mines remain to be removed, medical care for mine casualties is extremely limited and numerous episodes of violence against UNITA followers returning to their areas of origin have been reported.

Decades of atrocities, including rampant violations of the human rights of non-belligerents, make reconciliation exceedingly difficult. The entrenched interests undermine reforms, and after three decades of external intervention, Angola's government resists the international community's pre-conditions for its involvement and aid. New presidential and legislative elections are scheduled for 2006, the first in 12 years, but while the government would first like to agree on a new constitution, UNITA is pressing for earlier elections using the current constitution. The ruling party, the Popular Liberation Movement of Angola (MPLA), still enjoys international confidence and popular prestige as the heir to the independence heroes, while the opposition appears to be divided.

According to the 2004 Human Development Report, Angola ranks 166th out of 177 countries, with an estimated 68 per cent of the population living below the poverty line of $1.7 per day. Indeed, despite the oil boom, the majority of Angolans live in extreme poverty. The incidence of poverty is higher in rural areas – where it affects 94 per cent of the population, compared to 57 per cent in urban areas – as a result of the difficulty for farmers of gaining access to fertile land and markets, the deterioration of road infrastructure and rural dwellers' flight to urban centres, which were less affected by the armed conflict than rural areas. The latest household survey (2001) showed that 40 per cent of household heads were jobless, while urban unemployment stood at 46 per cent. It indicated that one-fifth of all children aged 5 to 14 years perform various jobs and 42 per cent of children of poor families are engaged in household work.

Major social indicators such as life expectancy, malnutrition and access to water and sanitation deteriorated sharply during the war and are still at alarming levels. In the 1990s, the international community was deeply involved in alleviating the Angolan humanitarian crisis and the country received considerable assistance, including food support. Donors' current strategy is to move from emergency interventions to a development approach, focusing their initiatives on achieving the Millennium Development Goals and fostering democratic governance. For that purpose, donors are pressing the authorities to step up the fight against corruption, improve transparency in the use of oil revenues, and enhance the quantity and quality of social spending on poverty reduction.

The Council of Ministers approved the PRSP in December 2003, and a subsequent revision process is supposedly almost complete. According to the donor community, the strategy lacks a clear prioritisation of objectives, actions, timeline and financing sources. Moreover, NGOs claim that consultation in the preparation phase has been insufficient. The formal conclusion of the PRSP is, therefore, subject to the incorporation of donors' comments and to the intensification of the consultation process with civil society, under the leadership of a PRSP donor working group. Concern has been expressed as to the country's ability to implement a monitoring and evaluation system to assess progress in its PRSP. The 2001 household survey, which is outdated and not representative of the whole country, cannot be used to assess the impact of PRSP implementation.

Two years after the cessation of hostilities, efforts to rebuild and to increase the availability of health services are lagging behind. Only 30 per cent of the population has access to basic health services within 5 km from their place of residence. The rate of maternal mortality is one of the highest in the world (1 700 per 100 000 births). According to UNICEF, Angola has the world's third-highest child mortality rate, with 250 deaths per 1 000 children, owing to malaria, respiratory infections, diarrhoea, measles and neo-natal tetanus. Malnutrition is an important underlying condition, estimated to affect almost half of Angola's 7.4 million children. In the next two years, the country is expected to receive $25 million from the Global Fund to implement measures to fight malaria. However, a national therapeutic policy has not been introduced yet, and medical institutions are struggling to provide adequate treatment even for common illnesses.

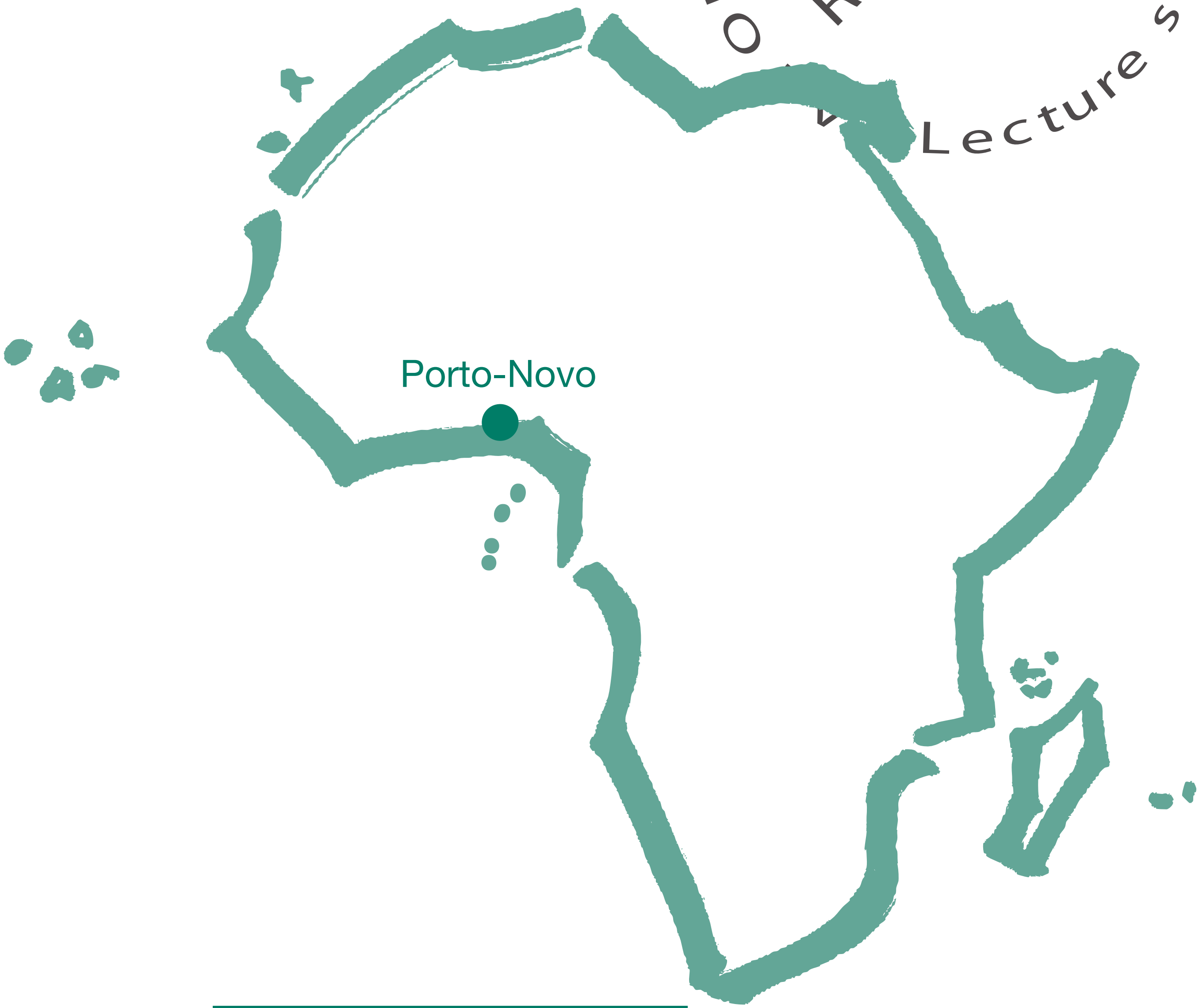
One of the root causes of the low rate of access to health services and the poor quality of those services is the low budgetary allocation for social expenditures. The meagre funds allocated to the health sector are then fragmented into distinct budgetary units at provincial level and dispersed in a large number of sub-sectoral policies, programmes and plans without a sector-wide plan of action. There is a huge shortage of doctors, with only one for every 13 000 people. The government has announced a broad package of measures providing incentives to health workers to work in the provinces, but progress in establishing them has been slow.

At an estimated 4.1 per cent in 2003, the HIV/AIDS prevalence rate in Angola was relatively low by the dramatic standards of Southern Africa, the sub-region of the world most severely affected by the epidemic. A new UNICEF survey, which involved testing some 12 000 women at ante-natal clinics in all 18 Angolan provinces, found that only 2.8 per cent of them were infected, which would imply an overall adult HIV infection rate of about 5 per cent. The relatively low prevalence of HIV has, however, led to a lag in medical response and extremely low budgetary allocations over the past three years. An important step in the fight against the disease was the launch of a National Plan against HIV/AIDS in January 2004. The five-year, $160 million national strategic plan, drawn up with the collaboration of the United Nations, is focused on prevention, building institutional capacity and helping HIV-positive people. Concern has been aroused, however, by the slow progress in implementing the plan, especially in setting up treatment facilities in the capital.

With an estimated illiteracy rate of 58 per cent (as against 38 per cent for the rest of Africa) and about one-third of all children aged 5 to 11 with no school education, Angola's educational indicators rank among the lowest in the world. During the 1990s, the Angolan education sector underwent a dramatic decline in enrolment, partly due to the hostilities but also to the failure to train and deploy adequate numbers of teachers, with sufficient teaching and learning materials. By the late 1990s, primary school enrolment was down to about 1 million. According to the latest national statistics available, the gross enrolment ratios for boys and girls are 78 per cent and 69 per cent respectively, and the net primary enrolment ratios 39 per cent and 35 per cent respectively. In addition, 35 per cent of the children who enrol in the first primary year fail to complete a full course of primary education. This reflects the high drop-out rates in all primary school grades, averaging 24 per cent of pupils in the first four grades. Gross secondary enrolment is also very low, at 18 per cent for boys and 13 per cent for girls. Low salary levels and arrears in salary payments have made teaching in the public sector an unattractive profession. Teachers have to resort to parallel jobs and, very often, to extort *gasosas* (kickbacks), making it even more difficult for the poor to access education. The number of pupils per classroom is very high (64) and the shortage of textbooks is acute.

The Ministry of Education has reformulated the *Plano-Quadro de Reconstrução do Sistema Educativo*, setting new targets to be achieved by 2015. The challenges remain enormous: in order to achieve universal primary enrolment and completion, while keeping pace with the rapid growth of the school-age population, the number of pupils enrolled in primary school needs to grow from an estimated 1.2 million in 2002 to 5 million by 2015. As a result of this recent effort, the 2004 school year has seen a massive increase in the number of students enrolled, by almost 2 million primary school children. In addition, in order to improve the availability and quality of primary education, the Ministry of Education and UNICEF have recently drawn up a national capacity building plan. In order to improve pedagogical skills, some of the 29 000 new teachers recruited last year will work with the newly developed teaching modules.

Benin



key figures

• Land area, thousands of km²	113
• Population, thousands (2004)	6 918
• GDP per capita, $ (2003)	528
• Life expectancy (2000-2005)	50.6
• Illiteracy rate (2004)	58

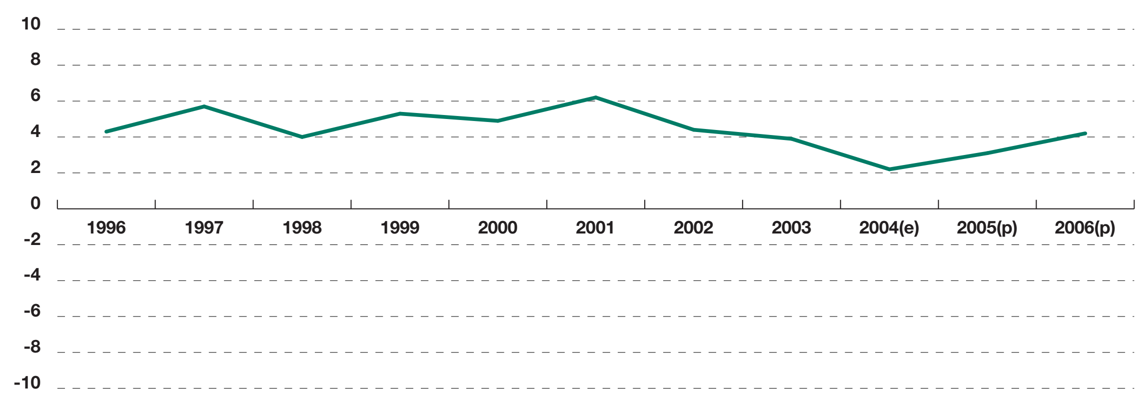
Benin's macroeconomic results have been satisfactory since the early 1990s, with annual growth averaging five per cent and inflation under control, accompanied by stable politics and great freedom of expression that is an example to the rest of Africa. But the mainstays of the economy have recently shown signs of fragility, slowing economic activity in 2003 and 2004.

Benin is very dependent on trade with neighbouring Nigeria and was badly hit when the Nigerians stepped up import restrictions at the end of 2003. This happened as Cotonou port, the country's main trading centre, was becoming less competitive. Unlike the ports of Tema (Ghana) and Lomé (Togo), it has not benefited from the diversion of trade from Abidjan because it has cumbersome procedures for getting goods out of the port and high official (and unofficial) tariffs. The country's through-roads are also slowed by numerous police checkpoints.

The cotton sector, which provides income for more than two million of the country's 6.8 million people and is Benin's main export, has been in major crisis since 2002 because of sector reforms begun in the early 1990s when world prices were low. Underhand behaviour by some in the sector is threatening the new structure of the industry and disrupting operations. Recent harvests have been much poorer than expected and have not exceeded 330 000 tonnes. As a result, national growth was held down to an estimated 2.2 per cent in 2004 and the revenue shortfall is cutting into the national budget and the government's development plans.

Worsening trade relations with Nigeria and crisis in the cotton sector threaten the economy.

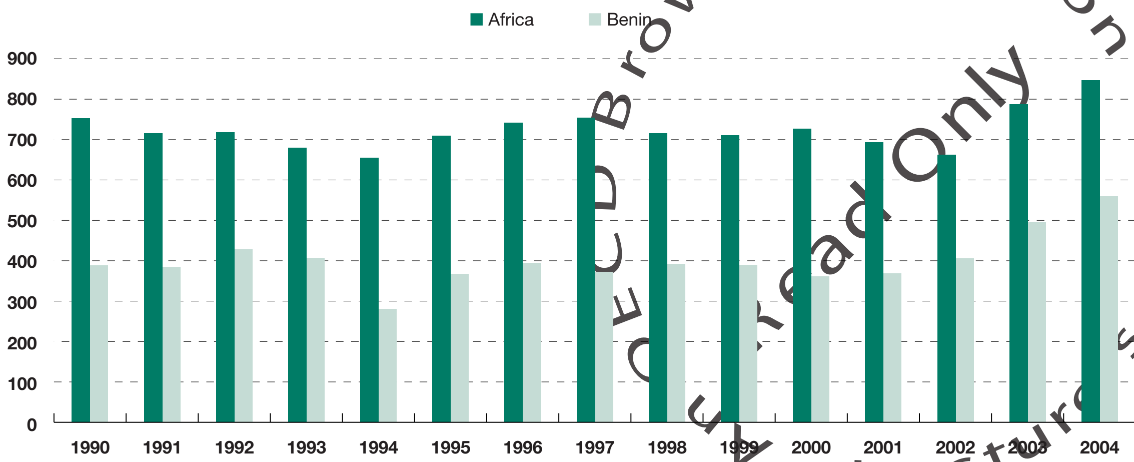
Figure 1 - **Real GDP Growth**



Source: *Institut National de la Statistique et de l'Analyse Economique(INSAE)* data; estimates (e) and projections (p) based on authors' calculations.

The outcome of the presidential election due in March 2006 is uncertain since neither President Mathieu Kerekou nor his main opponent can run again because they will be too old. The business sector is adopting a wait-and-see attitude that hinders structural reform and depresses the economy. Growth of 3.1 per cent is expected in 2005 and 4.2 per cent in 2006, below the average of the past decade.

Figure 2 - **GDP Per Capita in Benin and in Africa** (in current dollars)



Source: FMI.

Recent Economic Developments

The economy is largely dominated by the informal sector, which occupies 95 per cent of the workforce, according to the 2002 census. The primary sector's added value is virtually 100 per cent informal, that of industry more than 60 per cent and of tradable services 74 per cent. This makes it hard to assess their performance but helps explain why they can withstand external shocks. The cotton harvest was disappointing in 2004 and the country was hit by import restrictions imposed by Nigeria. Growth over the year was estimated at 2.2 per cent.

Agriculture has had problems since 2002 that have prevented it being the motor of growth it previously was. The primary sector grew an average 5.5 per cent a year between 1993 and 2002, but only 2.4 per cent in 2002 and 3.4 per cent in 2003, mainly because of problems in the cotton sector. Growth was slightly better in 2004, mostly thanks to a good food crop harvest.

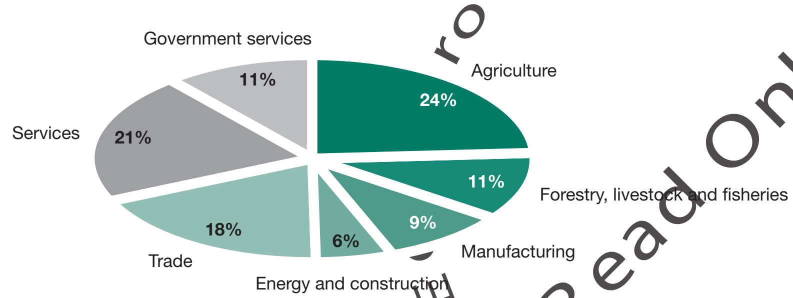
Apart from some areas of food shortage in the north, Benin has major food resources that make it self-sufficient. Cassava is the leading food crop, with more than 2 million tonnes grown each year, but the 2004/05 harvest is expected to be down 9 per cent on the previous very good years. Cereals output is chiefly maize, production of which is expected to amount to 928 000 tonnes in 2004/05, up 25 per cent on the previous year. Some of it is exported to the region, especially Nigeria, while other grains and tubers are consumed locally.

Cotton is a mainstay of the economy and its harvesting and processing contributes about 13 per cent of GDP and occupies 300 000 farms and two million people out of a total population of 6.8 million. Cotton also represents three quarters of all goods exports. The government launched a reform programme in the early 1990s to open up the sector and privatise the state firm that has long handled all operations (providing inputs, gathering the harvest, ginning and marketing).

However, it proved difficult[1] to realise and, together with very low world prices, disrupted the sector and produced poor harvests. After a peak of 412 000 tonnes of cottonseed in 2001/02, production fell back to about 330 000 tonnes in 2002/03 and 2003/04. Operators in the industry think this can be improved on and ginning capacity of 587 000 tonnes has been installed, well above actual production.

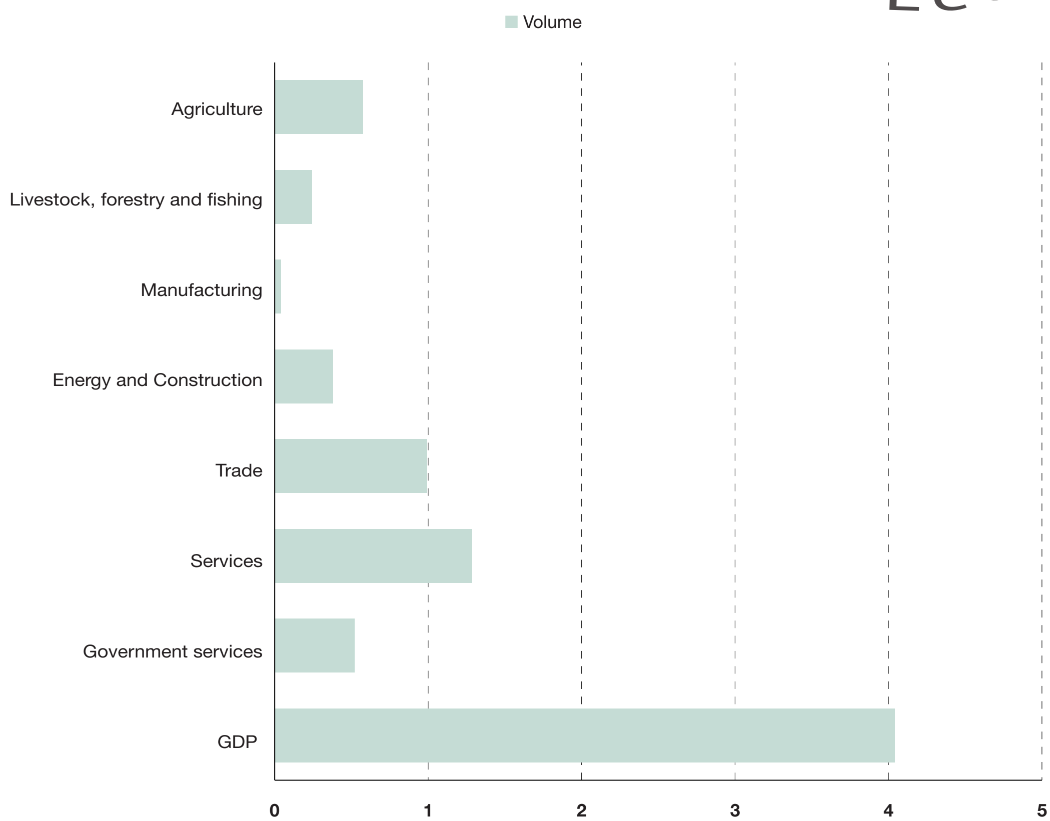
1. See section on Structural Issues.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on INSAE data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Note: National accounts include harvests of the year n/n+1 in the GDP of the year n, so the result of the 2003/04 harvest is carried over here.
Source: Authors' estimates based on INSAE data.

Prospects for cotton in 2005 are mediocre. The 2004/05 season began in an atmosphere of distrust and seems to be facing the same problems as in previous years – some of the inputs were supplied outside official procurement channels and also late. The harvest is thus expected to be the same as in 2003/04.

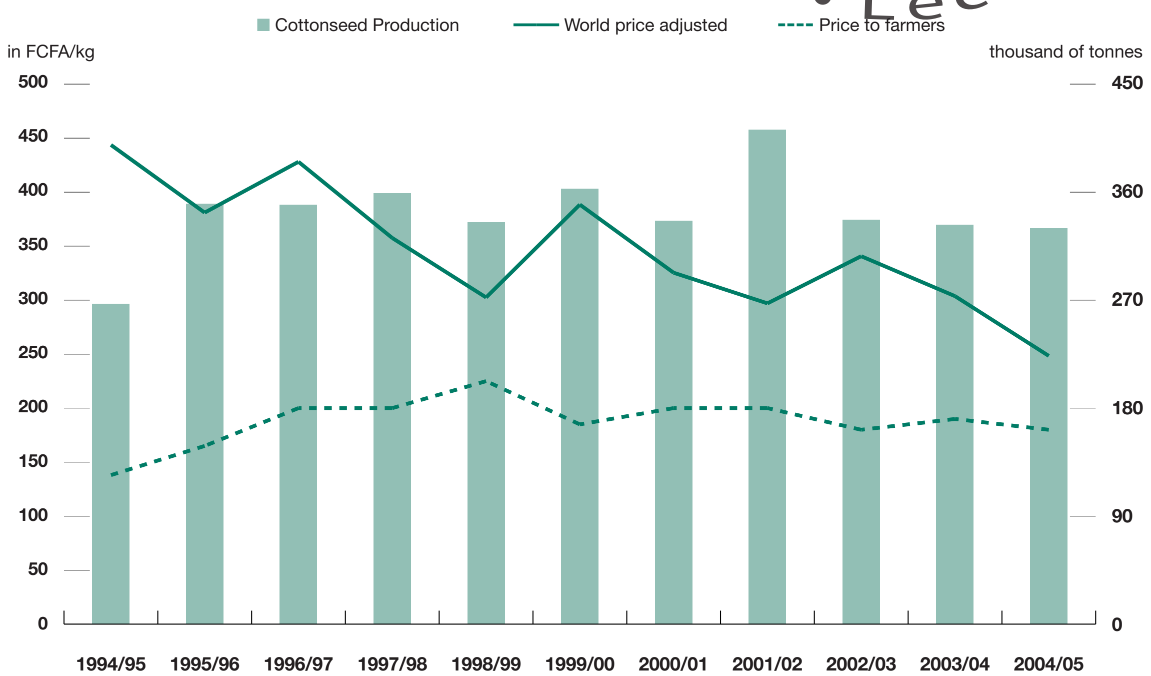
The price to growers is also uncertain. Despite a timetable for setting an interim price in March-April 2004 and a final one, related to world prices, in October-November, the final price to growers (200 CFA francs/kg) was not announced until the end of December, demonstrating the difficulty of reaching a decision when the world price is low and budget resources limited.

As in the 2001/02 season, the government pledged to subsidise the sector despite the problem of finding the money and the risk of worsening disruption if operators are not made to comply with the rules. The approach of a presidential election in early 2006 is not conducive to firmness, however, and makes a substantial increase in production unlikely as long as the sector reform is not sorted out.

Declining cotton production since 2002 has slowed down manufacturing (chiefly ginneries and textile factories), which had virtually zero growth in 2003 and contracted more than 1 per cent in 2004.

The services sector, especially commerce, has been hit by Nigerian restrictions on imports from Benin, the problems of Cotonou port and the country's less competitive situation with the stronger euro. The sector slowed down substantially, with the average 6 per cent growth between 2001 and 2003 falling to about 3 per cent in 2004.

Figure 5 - **Cotton production and prices in Benin**



Source: INSAE.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**17.6**	**19.7**	**18.5**	**20.3**	**18.2**	**18.7**	**18.8**
Public	6.1	6.8	7.4	7.5	7.0	7.2	7.2
Private	11.5	12.9	11.1	12.8	11.2	11.5	11.6
Consumption	**86.0**	**88.9**	**90.3**	**89.8**	**91.5**	**92.8**	**92.5**
Public	13.5	12.2	12.3	12.6	12.8	14.0	13.5
Private	72.5	76.6	78.0	77.2	78.8	78.9	79.0
External sector	**-3.5**	**-8.6**	**-8.8**	**-10.1**	**-9.7**	**-11.5**	**-11.2**
Exports	26.5	22.3	22.2	21	19.5	16.9	16.4
Imports	-30.0	-30.9	-31.0	-31.1	-29.3	-28.4	-27.6

Source: INSAE data; estimates (e) and projections (p) based on authors' calculations.

Growth in 2003 was driven by public and private investment which levelled off in 2004 due to the government's budget problems and the depressed business climate. After Nigeria's import restrictions, Benin's imports (which are mostly for re-export) and exports declined. Better relations with Nigeria and the lifting of many of the measures may restore a normal level of exports to Benin's big West African neighbour in 2005. However, mediocre cotton harvest prospects rule out any significant rise in exports and the external balance will probably decline.

Macroeconomic Policies

Fiscal and Monetary Policy

Benin's macroeconomic policy is mostly constrained by limited budget resources. Though the country complied with six of the eight convergence criteria set by the West African Economic and Monetary Union (WAEMU/UEMOA) in 2002, it has not managed to achieve basic fiscal balance and the tax burden is far below WAEMU's target of 17 per cent of GDP. Tax collection is rising but the customs service is weakened by fraud (under-valuing of imports and improper exemptions).

Recurrent strikes persuaded the government to grant bigger pay rises than planned in 2002 and 2003. Social spending and public investment remained well below targets and the country's needs. The government also has to face major external fluctuations. The very low world cotton price in 2002 persuaded the government to boost subsidies to growers.

Spending on parliamentary elections in 2003 exceeded the budget. But the rise in world oil prices only had a very small effect on public finances because Benin imports electricity from Ghana and Côte d'Ivoire (mostly hydro power) and smuggling of oil products from Nigeria is widespread.

Despite its problems, Benin has very good relations with the Bretton Woods institutions because of its good management of the budget deficit (held below 4 per cent of GDP between 1996 and 2002). So, since completion of the three-year International Monetary Fund (IMF) poverty reduction and growth facility (PRGF) in March 2004, the government has been negotiating for a new programme to cover 2005-07.

Current expenditure in 2003 was nearly 14 per cent higher year-on-year and 6 per cent over budget. Expenditure totalling 34.8 billion CFA francs was deducted from the 2004 budget to cover the overrun. Budgeted operations had a 17 billion CFA francs revenue shortfall at the end of first-quarter 2004, due to a sharp fall in customs receipts (40 billion CFA francs over the year, according to the economy and finance ministry) because of a fall in port activity after Nigeria's restrictions on Beninese imports and a general economic slowdown

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006(p)
Total revenue and grants[a]	**17.9**	**17.8**	**17.3**	**18.5**	**18.3**	**18.5**	**18.2**
Tax revenue	11.8	13.5	14.4	14.9	13.2	14.4	14.2
Oil revenue	3.7	2.5	1.0	2.0	3.4	2.4	2.3
Total expenditure and net lending[a]	**18.2**	**19.3**	**19.6**	**21.1**	**20.5**	**21.8**	**21.3**
Current expenditure	12.2	11.9	13.2	14.2	14.0	15.2	14.6
Excluding interest	*10.0*	*11.0*	*12.5*	*13.6*	*13.6*	*14.8*	*14.2*
Wages and salaries	4.8	4.4	4.6	5.0	5.2	5.7	5.6
Interest	2.3	0.8	0.8	0.6	0.4	0.4	0.4
Capital expenditure	5.9	7.4	6.2	7.0	6.5	6.7	6.7
Primary balance	**1.9**	**-0.6**	**-1.5**	**-2.0**	**-1.8**	**-2.9**	**-2.7**
Overall balance	**-0.3**	**-1.4**	**-2.3**	**-2.6**	**-2.2**	**-3.3**	**-3.1**

a. Only major items are reported.

Source: IMF and Ministry of Economy and Finance Data; estimates (e) and projections (p) based on authors' calculations.

that reduced direct and indirect tax revenue.

The stronger euro also boosted the price of Benin's exports compared with Nigeria's in 2003 and 2004, making them less competitive. Trade recovered somewhat from second-quarter 2004 but tax revenue for the year was expected to be 13.2 per cent of GDP in 2004, substantially down from the 2003 figure of 14.9 per cent, though it was made up for by a big rise in grants, from 2 to 3.4 per cent of GDP.

As a result, the government decided to make budget cuts totalling 30 billion CFA francs in 2004, involving all ministries and causing disruption in the spending chain. Investment was reduced and also spending under the Heavily Indebted Poor Countries (HIPC) Initiative. Primary expenditure (budgeted current and capital spending) was estimated at the end of September 2004 as 234.5 billion CFA francs, well below the planned 250.9 billion. Budgeted spending was down 0.6 percentage points of GDP in 2004 year-on-year because of less capital spending.

The budget suffers from persistent under-implementation of capital spending, while current spending, especially for wages and salaries, exceeds targets. This is unlikely to change in 2005 and 2006 since the government has promised civil service trade unions, which staged several strikes in autumn 2004, that it will pay 200 billion CFA francs of salary arrears (resulting from a 1987-92 promotions freeze) and increase salary scales. This may have a long-term effect on public finances because the payments will be partly direct and partly through long-term treasury bonds. The 2005 and 2006 budgets will also have to pay for the March 2006 presidential election.

So the budget deficit is expected to worsen to 3.3 per cent of GDP in 2005 and 3.1 per cent in 2006, mostly due to increased current spending while tax revenue should remain steady. Better capital spending implementation will require greater use of external funding. In the 2003 budget, 72.6 per cent of planned capital spending was implemented, but only 59.3 per cent of scheduled external funding was used (only 40.3 per cent for grants), compared with 92.3 per cent of domestic funding.

The government has taken steps to boost tax collection and streamline public spending. These include the creation of a public spending monitoring system, compulsory use of a one-stop government payments centre, co-operation between the customs and tax departments and computerisation of their systems as a mean of combating tax evasion. Reform of procurement procedures and internal monitoring has begun and reduction of dependence on customs revenue is being considered as part of economic opening-up. The aim is to collect more taxes from the extensive informal sector.

Despite pressure to increase wages and higher petrol prices, inflation is under control in Benin, as in other WAEMU countries, because of the stronger euro and good food crop harvests, Inflation fell from 4.2 per cent in 2001 to 2.5 per cent in 2002, then to 1.5 per cent in 2003 due to lower prices of food, beverages and tobacco. This was offset by sharp rises in the cost of "housing, water, electricity and other fuel" (5.1 per cent) and transport (9.8 per cent) under the impact of higher oil prices.

Inflation was still under control in 2004, when it was only 0.1 per cent, though strong demand for food products from neighbouring Sahel countries whose crops were hit by locusts slowed the fall in food prices. Inflation should be around 2.5 per cent in 2005 and 2006, below the WAEMU convergence criterion of 3 per cent.

External Position

Benin has a structural trade deficit because of the scale of its food imports and the informal nature of re-exports (imports are counted but exports are not well measured). Remittances by Beninese abroad are too small to make up for the trade imbalance so that the current account balance has a deficit of between 3 and 8 per cent of GDP.

Benin remains mostly dependent on cotton exports and on re-exports to Niger and Nigeria, which combined account for two-thirds of the country's goods and services exports. The government is trying to reduce dependence

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-5.2	-7.2	-8.2	-8.6	-8.5	-9.8	-9.5
Exports of goods (f.o.b.)	18.0	15.0	15.9	14.2	13.5	11.4	11.0
Imports of goods (f.o.b.)	-23.2	22.1	-24.2	-22.8	-21.9	-21.1	-20.5
Services	-2.6	-1.8	-1.7	-1.8			
Factor income	-1.9	-0.5	-0.5	-0.5			
Current transfers	4.9	6.5	4.5	4.8			
Current account balance	**-4.9**	**-3.0**	**-5.9**	**-6.2**			

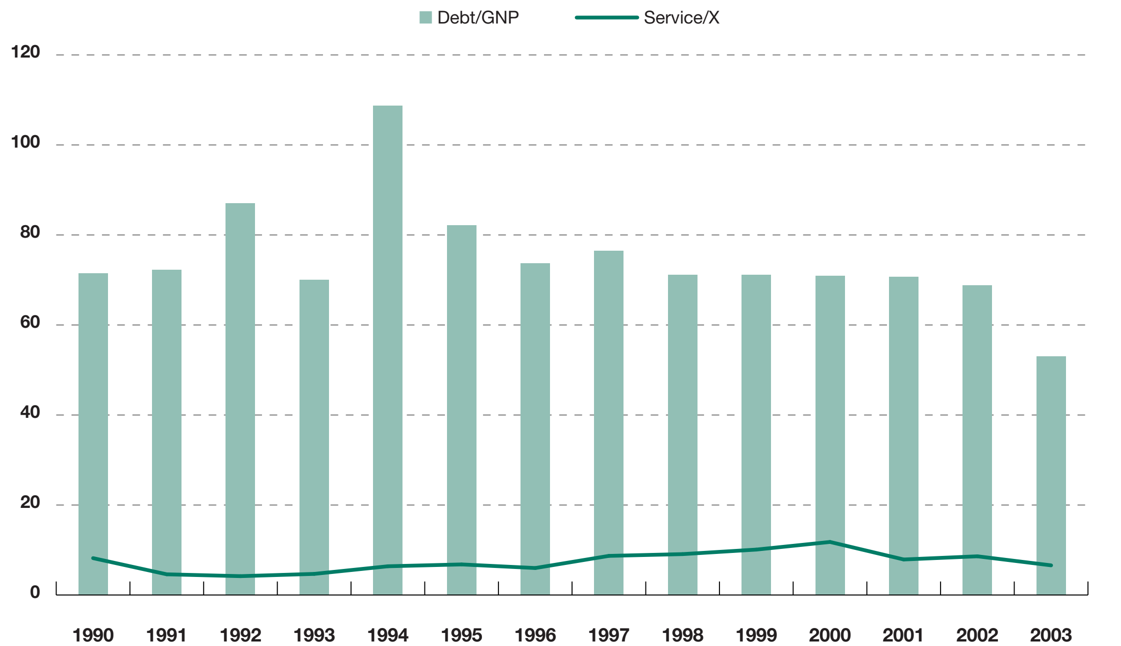
Source: BCEAO data; estimates (e) and projections (p) based on authors' calculations.

on cotton by expanding agricultural exports to cashews (processed and packed in India), palm oil and shea butter. But diversification is going slowly.

Exports to Nigeria are mostly informal and trade consists of a large amount of re-exports and informal exports (and re-exports) that amount to about 6 per cent of GDP. The re-exporting is due to importers trying to get round Nigeria's tight trade restrictions and customs duties averaging 37.2 per cent, compared with Benin's 14.6 per cent. The closeness of Lagos (130 km) is also a major factor, as well as security problems and congestion at its port of Apapa.

Nigeria expanded its list of banned imports at the end of 2003 from 28 to 44 kinds of product and tightened border controls, which cut activity at Cotonou port by 20 per cent between January and April 2004 year-on-year. The Nigerians lifted the ban on Beninese-made goods in 2004 after discussions but maintained a ban on re-exports. The sharp drop in imports to Benin in early 2004 was followed by a recovery, suggesting traders had found new informal ways to get their goods into Nigeria. Despite the low level of imports since

Figure 6 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of export)



Source: World Bank.

2003, Benin was unable to improve its trade balance because of sluggish exports, especially of cotton, so that the balance's percentage of GDP remained steady in 2004.

Little short-term improvement is expected because, apart from Benin's problems with Nigeria, Cotonou port, through which 90 per cent of the country's trade passes, is inefficient. With an annual capacity of 4 million tonnes, it is West Africa's fifth biggest, after Lagos (Nigeria), Abidjan (Côte d'Ivoire), Tema (Ghana) and Dakar (Senegal). Traffic increased substantially between 1998 and 2002, but businesses complained of delays in unloading and customs processing and of high costs whether in the form of tariffs or corruption and red tape. They also drew attention to the number of police roadblocks at the port and all along the country's through-roads.

Port activity has slowed since 2003 and more and more goods have entered the country by other means. The significant growth of Lomé and Tema as alternative ports to Abidjan has jolted Benin's political and economic decision-makers into awareness of the problems of Cotonou's port. Apart from the extra charges which businesses cite as an obstacle to the port's development, tighter application by Benin of WAEMU's common external tariff may have hurt Cotonou, to the advantage of Lomé. Benin's major focus on Nigeria, to the east, may also have lost it opportunities to the west.

Benin's external debt was 832.6 billion CFA francs at the end of December 2003 (about 40 per cent of GDP), 82 per cent of it due to multilateral creditors. The amount has fallen substantially since 2001 thanks to about 55.3 billion CFA francs of debt relief obtained under the HIPC Initiative since the country reached decision point in July 2000 and completion point in March 2003.

Structural Issues

Benin began to energetically open up its rigidly state-controlled economy in the early 1990s and then in the middle of the decade launched a profound reform of the cotton sector, handed some port operations over to the private sector and began divesting public service companies. But the reforms have stalled in recent years.

The government chose to privatise the cotton sector completely, though still with an entirely vertical structure and run by an association of growers, inputs suppliers, ginners and the government. Sonapra, the state cotton firm in charge of all production and marketing, was gradually transferred to the private sector from 1992. First to go was haulage of cottonseed, then distribution of inputs. Sonapra's monopoly of ginning was ended in 1995. Licences were granted to three firms for collecting and ginning and five more were granted in 1997 and 1998.

Since 2000, Sonapra's monopoly for marketing cottonseed has been abolished and management of input supply handed to the private sector (the inputs supply and management co-op, Cagia, was given the task of choosing among the tendered bids). The price to the grower has been negotiated since 2001 between producers' associations and ginneries belonging to the cotton profession association, AIC. But the last stage of the reform, privatising Sonapra's remaining ginneries, was delayed and only three of the four lots scheduled for sale have been divested so far under widely contested conditions.

The reforms have been hampered by low world prices, poor harvests in recent years and breakdowns in the new regulatory system, which was based on the assumption that everyone would obey the rules and that the government and the courts would ensure that it functioned correctly. But in the 2000/01 season, some input distributors who had not been chosen by tender sold their products, some of them of poor quality, to "rebel" growers who produced nearly 10 000 tonnes of cottonseed (out of a total production of 330 000 tonnes) in the 2003/04 season.

Some ginneries also refused to pay the 40 per cent deposit for their future purchases of cottonseed to the state debt recovery and secure payments body, CSPR. These dissident ginners handled 60 000 tonnes of cotton during the 2003/04 season (including the 10 000 tonnes from the rebel growers). The CSPR's financial stability is vital, as it repays bank loans for inputs with the deposits from the ginneries and also pays growers after deducting the cost of the inputs. With some ginners not paying their deposits and Sonapra's late payments, the CSPR was unable to pay growers on time and in early December 2004 it still owed them 1.2 billion CFA francs for the 2003/04 season.

The government seems reluctant to do much about the rebels. The dissident ginners appear to have got public money to divert cotton to their factories. Despite their conduct, they were nevertheless among the bidders chosen to take over Sonapra's ginneries. The July 2004 national cotton conference that was meant to settle the disputes was rejected by growers and the CSPR as unrepresentative. The commerce ministry's effort in the autumn to manage the deposits of the ginners directly was criticised because the account that was to receive the money was not transparently managed.

This refusal to obey the rules by some of the parties involved could spur others to leave the system altogether. The prospect of bigger profits, at least in the short term, could persuade other ginners to refuse to pay the CSPR and so buy cottonseed without paying for the inputs to produce it. The resentment of some growers towards the bodies supposed to pay them may lead them in turn to refuse to pay the 10 CFA francs tax to maintain industry support structures.

All these problems leave the cotton sector less competitive, with input debts unrecovered and vital functions which have to be paid for by an increase in the charges borne by those who stay in the system. They also cause growers to switch to other crops, using fertilisers meant for cotton. In the longer term, the fragility of the system also risks affecting spending on research and development, leading, ultimately, to a reduction in cotton quality.

To tackle the loss of competitiveness of the port of Cotonou in relations to its direct rivals(especially Lomé), the government has announced a economic revival plan based on improving customs procedures, fighting corruption, removing illegal checkpoints on roads leading from the port and streamlining the one-stop office there. Removal of checkpoints from through-roads will be studied with circumspection, however, because of the rise in crime it could engender.

Studies are being carried out into the construction and franchising of a second deep-water port to relieve congestion at the existing one. A reform was also launched in the late 1990s to open the present port to private management and a feasibility study has been completed. But the port's strategic importance, especially for customs revenue, makes any change a delicate matter. Strong trade unions and hesitant political leadership, as shown by the change in port director in autumn 2004 after only six months, have so far blocked the reform. The authorities have also been thinking for some years of installing a duty-free zone.

The government has said for several years it wants to privatise public services such as telecommunications and electricity but little has been done. The post and telecommunications office (OPT) was split into two operations in May-June 2004, Benin Télécom and La Poste du Benin. The plan is to open up the capital of Benin Télécom in 2005 to a strategic partner, who will be offered a capital stake of up to 40 per cent, as well as to local investors and employees. The state will keep 15 per cent of the capital.

The former state electricity firm SBEE has already been divided up and a consultant is evaluating its assets. The government plans to complete the public service reforms by the end of 2005 but this deadline is unlikely to be met as, at the end of 2004, the regulatory authority was still not in place.

Benin has clear comparative advantages (political stability, physically strategic position and modern ports and roads) but its business climate is not very suited for growth of the private sector. The country has drawn less foreign direct investment than other WAEMU members, except during the privatisation period of the early 1990s, according to UNCTAD (the UN Conference on Trade and Development).

It says complicated bureaucracy, confusion over the roles of the promoting bodies (such as the chamber of commerce and the one-stop shop), the weak legal system (lengthy procedures and lack of trained and independent judges) and poor governance all seriously obstruct private enterprise. Costly procedures are also very discouraging. Setting up a business costs roughly twice the per capita average annual income, according to the World Bank.

Financial intermediation is still very limited in Benin, as in other WAEMU countries. The penetration ratio (M2/GDP) has been no more than 32 per cent over the past three years. Loans to the private sector were only 12 per cent of GDP in 2002. The financial system comprises eight commercial banks, two leasing companies, eight insurance firms and over 100 formal-sector micro-credit institutions. The insurance sector has grown considerably since 1995 but is still small. No local stock exchange exists and very few firms use the regional one, the BRVM.

Three banks dominate what is a relatively concentrated banking market. All banks except one are privately-owned and most are foreign. The sector is generally solid and the banks have recently improved their profitability and compliance with prudential ratios (except for risk concentration). The proportion of non-performing portfolios (5.4 per cent) is one of the region's lowest, but though commercial banks hold more than 90 per cent of the financial sector's funds, their customers are few and mostly in urban areas.

Micro-credit has boomed nationwide over the past decade, especially in the poorest regions where banks are few, and the sector managed to reduce its non-performing loans from 8 per cent in 1999 to 5 per cent in 2003. But 2004 and 2005 have been difficult for the sector because of the problems in the cotton sector, in which very many customers work.

The strengthening of the financial sector has not been matched by growth of funding for small and medium-sized enterprises (SMEs). Benin is the only WAEMU country with an agreed definition of an SME (drawn up in 1997),[2] but current data on the sector is lacking. A 1997 survey said nearly half of all 666 SMEs counted were in commerce and the rest in construction, pharmacy, restaurants and other services. Only 17 per cent were in industry.

A 1999 follow-up study by the ministry of industry and SMEs of 692 micro-enterprises[3] said they were mostly informal since 80 per cent of them were not registered by any public body and 97 per cent were not in the official business register. Most (72 per cent) were in agro-food.

The financial sector crisis in the 1980s wiped out all the special facilities for funding SMEs. The commercial banks were held to strict prudential ratios guaranteeing the viability of the sector. So despite over-liquidity, the banking system provided SMEs with very little funds. The dearth of long-term funding was a major block to firms wanting to invest. Banks also did not have suitable means to assess the solidity of SMEs in the absence of a dependable legal structure (no commercial courts, few property guarantees and problems with activating them in the case of default).

So the commercial banks rely on trust and increase their loans to customers gradually as they prove their reliability. They also give credit for commercial orders. Leasing was introduced by the Bank of Africa (BOA) in 1995 but is very little used because of recent problems formal sector firms have had trading directly with Nigeria, notably where frozen foods are concerned.

SMEs therefore mostly turn to micro-credit institutions, whose customers increased by 75 per cent between 1998 and 2002 to reach half a million (about 15 per cent of the workforce), while total savings deposits rose by 160 per cent (to 32 billion CFA francs – $51 million

2. Defined as any legally-constituted (officially-registered) business that keeps regular accounts, is not a subsidiary of a multinational company and has between 5 and 50 permanent employees, share capital of between 1 and 50 million CFA francs or investments of between 5 and 500 million CFA francs.

3. Firms with share capital of 1 million CFA francs or less (or investments of less than 5 million) and with up to five permanent employees.

– on 31 December 2002) and loans by 250 per cent (to 46 billion CFA francs – $69 million). In this way, despite its small size, Benin has more micro-credit institutions than any other WAEMU member country.

The average savings account size has changed little over the years and is around 220 000 CFA francs ($352), but the size of loans rose 44 per cent in five years to an average 315 000 CFA francs in December 2002 (133 per cent of per capita GDP).

Two parallel networks have developed – friendly societies, led by the savings and mutual agricultural credit federation Fececam, which turns savings into loans, and direct credit institutions, which get funds on the financial market and from government and funding agencies, through the micro-enterprise development support project, PADME, and the SME support association, PAPME.

Micro-credit is expensive (about 2 per cent monthly interest) and funding goes mainly to agriculture and commerce, leaving out craft industries. So a large section of the population continues to use the old system of tontines[4] to save and start up businesses. Micro-credit institutions also have their own funding problems, though the sector is slowly becoming more professional.

The government drafted a special programme in

Micro-credit in Benin, a Robust Sector Funding SMEs: Fececam and Papme

Fececam (The Federation of Savings and Mutual Agricultural Credit Banks) groups institutions that make loans on the basis of collected savings. At the end of September 2004, it had 101 offices throughout the country (including a score in urban areas), 420 000 adherents, 31.5 billion CFA francs in deposits and 24.5 billion CFA francs in loans to some 90 000 borrowers, mostly farmers, livestock owners and traders.

Fececam specialises in rural loans of between 100 000 and 2 million CFA francs over about eight months at 2 per cent monthly interest. Security for loans is the existence of solidarity groups. In urban areas, it makes loans to traders who provide material security (plots of land, lorries and houses) for loans over 200 000 CFA francs.

Fececam has an overall collection rate of 89 per cent (95 per cent for loans to traders), with big variations according to the state of agriculture. Fececam has trouble converting the short-term funds it collects into long-term deposits, partly because the long-term savings deals it offers are not much taken up. It also complains about the ineffective legal system, which makes it impossible to recover small debts, makes loans more expensive and thus seriously limits the funding of SMEs. Strengthening risk protection for micro-finance users, an experiment that has been suspended for lack of funds, would certainly reduce the danger of defaults.

Papme (Association for the Promotion and Support of SMEs) was set up in 1993 as a project backed by the government and the World Bank and became an economic association in July 1999 with the objective ultimately of raising money on the capital market and so becoming more independent. It originally encouraged the growth of SMEs but since 2000 has focused on access to funding.

Papme has 25 offices around the country but most of its activity is in urban areas. It uses mainly external funding but since 2003 has been developing means to collect savings (standard, demand and time deposits). It has extended its range of financial products to include guarantees to firms, money transfers, investment credits and individual loans. It made loans of 21 billion CFA francs in 2003 (to 11 233 customers – 48 per cent more year-on-year), mostly short-term (93 per cent) and to commerce (90 per cent). The collection rate was 95 per cent.

4. Tontines are freely recruited groups of people who on set dates pay in variable sums (from 25 CFA francs to 1 million) and take turns in receiving the total payment. Non-compliance with the rules leads to social exclusion.

2001 to promote SME/SMIs between 2002 and 2004 with the aim of boosting their productive capacity. The authorities aim to help the private sector by supporting various micro-credit institutions and setting up a guarantee fund run by PAPME and PADME. The programme will be completed with a fund to promote SME/SMIs through the funding of surveys and assistance, as well as the provision of risk capital and loan guarantees. But these measures and institutions to help SMEs are still not very common and are mostly developed by donors over periods which are sometimes unsuited to the need for long-term development.

Political and Social Context

Benin is politically stable and has held free elections since 1990. Democracy has been accompanied by decentralisation, confirmed in the country's first local elections in December 2002, but lack of trained people and local funding has greatly slowed the planned transfer of responsibilities and resources. President Mathieu Kerekou was elected to a second term in March 2001 while parties backing him won a large majority in parliamentary elections in March 2003.

The next presidential election is due in March 2006, but neither Kerekou nor his main rival, former President Nicéphore Soglo, will be eligible because of the age limit set by the national constitution. Amending the constitution to allow them both to stand is being fiercely debated but this seems increasingly unlikely due to lack of time before the vote. The vigour of civil society, the media and trade unions also makes such a change unlikely.

Despite its political stability, Benin has governance shortcomings, serious corruption and a weak legal system. Transparency International put the country at 77th place on its 2004 worldwide corruption index, with a mark of 3.2, level with Egypt, Mali and Morocco. The country's freedom of expression has highlighted these problems, making comparison with less democratic countries difficult.

The stagnation of Cotonou port, linked to problems in the cotton sector, seems nevertheless to be a sign of serious governance problems. A five-month trial ended in June 2004 with the jailing of officials and judges for forging expenses claims between 1996 and 2000. The authorities, who have adopted an anti-corruption strategy, set up a national corruption monitoring centre in September 2004. The anti-corruption laws exist but they are hard to enforce in a weak legal system that makes punishment little credible. This creates discontent in civil society and fuels protests and strikes.

Benin has made a radical switch since 1990 from a state media monopoly to complete freedom of expression, something quite rare in Africa, and the written press is free and energetic. But its impact is limited since it is mainly directed at an educated elite in a country where barely 40 per cent of people can read. It also seems not to be echoed very much by civil society, the legal system and the government. Employers and trade unions are very active but are mostly interest groups with special demands.

Benin's relations with its neighbours have been dominated since 2003 by problems with Nigeria, starting in mid-2003 with a scandal centred on a businessman from Niger, Tidjani Hamani, living in Benin and accused of handling cars stolen in Nigeria. The Nigerian government accused Benin of not combating cross-border crime and closed the border for a week. Curbs on imports from Benin were greatly tightened in January and March 2004 and Benin is seeking ways to reduce dependence on its neighbour.

The country is one of the main promoters of the World Trade Organisation (WTO) Cotton Initiative to eliminate export subsidies and create a funding arrangement to cover losses.

Benin is small, with 6.77 million inhabitants (47 per cent of them under 14) and a social development level similar to its neighbours. Infant mortality (for children under 5) is 146.4 per 1 000 according to the 2002 census, compared with Ghana (88), Nigeria (127), Togo (131), Burkina Faso (154) and Niger (203). Life expectancy is 50.8, about the same as Togo (50) and Nigeria (51.3). Benin is placed 161st out of 177 countries on the worldwide Human Development Index compiled by the UN Development Programme (UNDP) and, despite improvements in health and education, is unlikely to achieve the 2015 Millennium Goals.

The fight against poverty, spelled out in a poverty reduction strategy paper (PRSP), involves medium-term improvement of the macroeconomic situation, boosting human skills and environmental management, strengthening governance and getting poor people involved in decision-making and production.

But a 2003 progress report on the PRSP's implementation said poverty was only being reduced slowly. It said 28.5 per cent of Beninese were poor in 2002 (29.3 per cent in 1999), that monetary poverty was worse in rural areas (31.6 per cent) than in towns (23.6 per cent). Inequality among poor people worsened between 1999 and 2002 as urban poverty deepened.

A questionnaire for basic welfare indicators for 2003 showed that 22 per cent of people lived in extreme poverty and did not get enough to eat, resulting in 30 per cent of children under five being malnourished in 2001. They also had retarded physical growth which worsened between 1996 and 2001. This is disturbing because the country had good economic growth (5.3 per cent) at the time and because the cotton sector's current problems may make things worse for the rural population.

Malaria is very common, affecting 36 per cent of all ill people in 2003 and 120 people per 1 000. But deaths from it have steadily declined, from 316 in every 10 000 cases in 1996 to 70 in 2002. The government wants to reduce malaria morbidity and mortality 30 per cent by 2005.

The incidence of HIV/AIDS is quite small and stable, as in Ghana. Only 1.9 per cent of pregnant women in Benin were infected in 2002 (2.3 per cent. in Cotonou). The government focused on prevention and limited care of the ill to avoid the disease spreading in a country that is a much-used transit route for outsiders. Tests are free but a basic diagnosis is expensive, at 40 000 CFA francs ($73.50). Adult patients are required to contribute to the cost of their anti-retroviral drugs in proportion to their income, though most pay the minimum (1 000 CFA francs).

Health care is accessible for 82 per cent of Beninese, though it varies widely by province (50 per cent in Littoral, 67 in Zou and 71 in Collines). Many local clinics are not yet up to standard and properly equipped. Health-care workers are in short supply because very many have retired and not been replaced and new ones are not well-trained. Only 35 per cent of the population used the health facilities in 2002, reflecting the inadequate services but also obstacles to access, such as extra charges.

Benin has very low literacy – 42 per cent in 2004. Among its neighbours, Ghana has 75.9 per cent, Togo 62.2, Nigeria 69.4, Burkina Faso 27.5 and Niger 18.2 per cent. The figure reflects poor education of the adult population. The UNDP says 98 per cent of school-age boys are in school but only 57 per cent of girls. Gross primary school enrolment has risen from 55.7 per cent in 1990 to 87 per cent in 2003. But gender disparity remains large and the overall primary enrolment figure nationwide was 95 per cent for boys and 79 per cent for girls.

Only 49 per cent of boys and 35 per cent of girls completed primary education in the 2002/03 school year. The government wants to increase the overall primary completion figure from 46 per cent in 2001/02 to 56 per cent in 2005/06. Its action programme aims to boost enrolment of girls from 65 to 80 per cent in primary and from 10 to 20 per cent in secondary between 2001 and 2006.

Laws that comply with International Labour Organisation norms ban children between 6 and 14 from working, but a quarter of all children (including over 55 per cent of girls) between 6 and 9 had some kind of economic activity in 2002. Some of them (estimated at 10 000 between 1996 and 2000) were trafficked throughout West Africa, where Benin is a centre of the trade. The children were sent to Côte d'Ivoire, Gabon and Nigeria to do domestic labour or work in mines or export agriculture. The situation is hard to tackle because it is part of the country's traditions and arises from the poverty of some parents and weak border controls.

Botswana

key figures

• Land area, thousands of km^2	582
• Population, thousands (2004)	1 795
• GDP per capita, $ (2002/2003)	4 440
• Life expectancy (2000-2005)	39.7
• Illiteracy rate (2004)	19.4

WITH A TRACK RECORD OF sound macroeconomic policies, good governance, reliable institutions and political stability, Botswana remains one of the top-performing economies in Africa. The country has managed its diamond wealth efficiently, in stark contrast to the widely cited cases of natural resource curse experienced by many developing countries. Botswana also has the reputation of being the least corrupt country in Africa and has the highest sovereign credit rating on the continent. These virtues, together with prudent macroeconomic management, have helped Botswana to achieve decades of robust economic growth, transforming itself from one of the poorest countries in the world to a middle-income country. With real per capita income currently in excess of $4 700, Botswana is one of the richest countries on the African continent.

Botswana faces difficult challenges in the years ahead, however, as the economy remains heavily dependent on diamond production, which is near full capacity, and an HIV/AIDS epidemic threatens to undermine past economic gains. To respond to these challenges, Botswana in 2003 launched the Ninth National Development Plan (NDP9) covering the period 2003/04-2008/09, which focuses on diversifying the economy away from mineral production and addressing the problems of unemployment and poverty. Concurrently, the authorities have prepared a comprehensive National Strategic Framework (NSF) for HIV/AIDS that consolidates all the programmes related to the pandemic and is considered to be among the best in Africa.

The end of growth in the diamond industry and high HIV/AIDS infection rates threaten a historically high-performing economy.

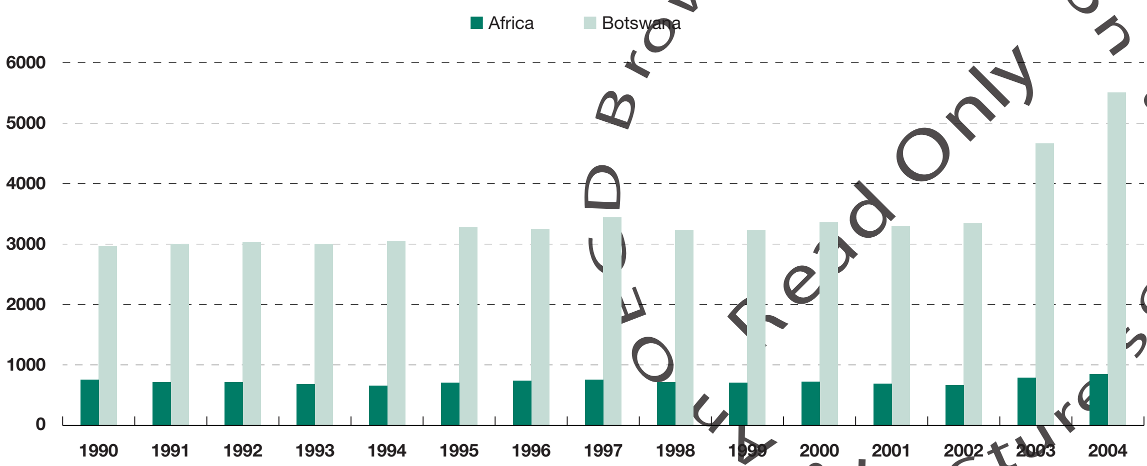
Botswana is also likely to be severely hit by the end of the Multi-fibre Agreement (MFA) on 31 December 2004, which paves the way for quota-free trade in textiles and clothing. Despite the protection Botswana enjoys under the African Growth and Opportunity Act (AGOA), this will expose the country to competition from larger low-cost producers, such as China and India, which can sell their goods at lower prices on the global market.

Figure 1 - **Real GDP Growth**

Source: Bank of Botswana and IMF data; estimates (e) and projections (p) based on authors' calculations.

Real GDP continued to grow at a strong pace in 2002/03 and 2003/04 (5.5 per cent and 5.2 per cent respectively)[1], owing to productivity gains in the diamond sorting process and good performance in the

Figure 2 - **GDP Per Capita in Botswana and in Africa** (current $)



Source: IMF.

private non-mining sector. The latter suggests that the authorities' efforts to diversify the economy are starting to take hold. Growth is expected to slow in the medium term, however, owing to the levelling off of diamond production and the impact of HIV/AIDS. Inflation declined in response to prudent monetary policy. The devaluation of the pula, Botswana's currency, in February 2004 helped maintain external competitiveness despite the appreciation of the South African rand and the US dollar, to which the pula is pegged. After two consecutive years of fiscal deficit, the overall fiscal balance was slightly in surplus in 2003/04, as capital expenditure was scaled down to offset revenue shortfall.

Recent Economic Developments

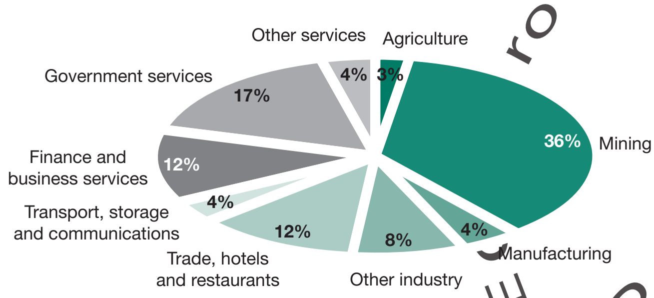
The economic fortunes of Botswana, the world's largest exporter of diamonds, are largely driven by developments in the mining industry. The mining sector as a whole is the largest contributor to GDP, export earnings and government revenues. In 2003/04, the share of the mining sector in GDP was 34.7 per cent, down slightly from 35.9 per cent in 2002/03. This was largely attributable to the drop in the international price of diamonds, which led to a 12.4 per cent decline in the value of Botswana's diamond output. The outlook for 2004/05 is positive, as substantial foreign investment is expected to bring efficiency gains in diamond production.

The non-mining sectors show considerable variation in their GDP shares. General government services appear to command the lion's share of GDP, with around 17.2 per cent in 2003/04, followed by financial services (10.5 per cent) and retail/wholesale trade and hotel services (10.2 per cent). This is not surprising, given that the government plays a leading role in the implementation of public investment and development programmes, as well as being an important source of wage employment in the country. Thus, government-induced demand has been very significant for the growth and development of the domestic economy.

Agriculture, which at independence accounted for the largest share of GDP, now contributes less than 3 per cent. The level of industrialisation in Botswana is low, as reflected in the relatively small proportion of real GDP originating in the manufacturing sector. Despite the increased pace of modernisation and diversification in recent years, occasioned by the government's multifarious interventionist policies, the GDP share of manufacturing, which averaged 5.7 per cent in the

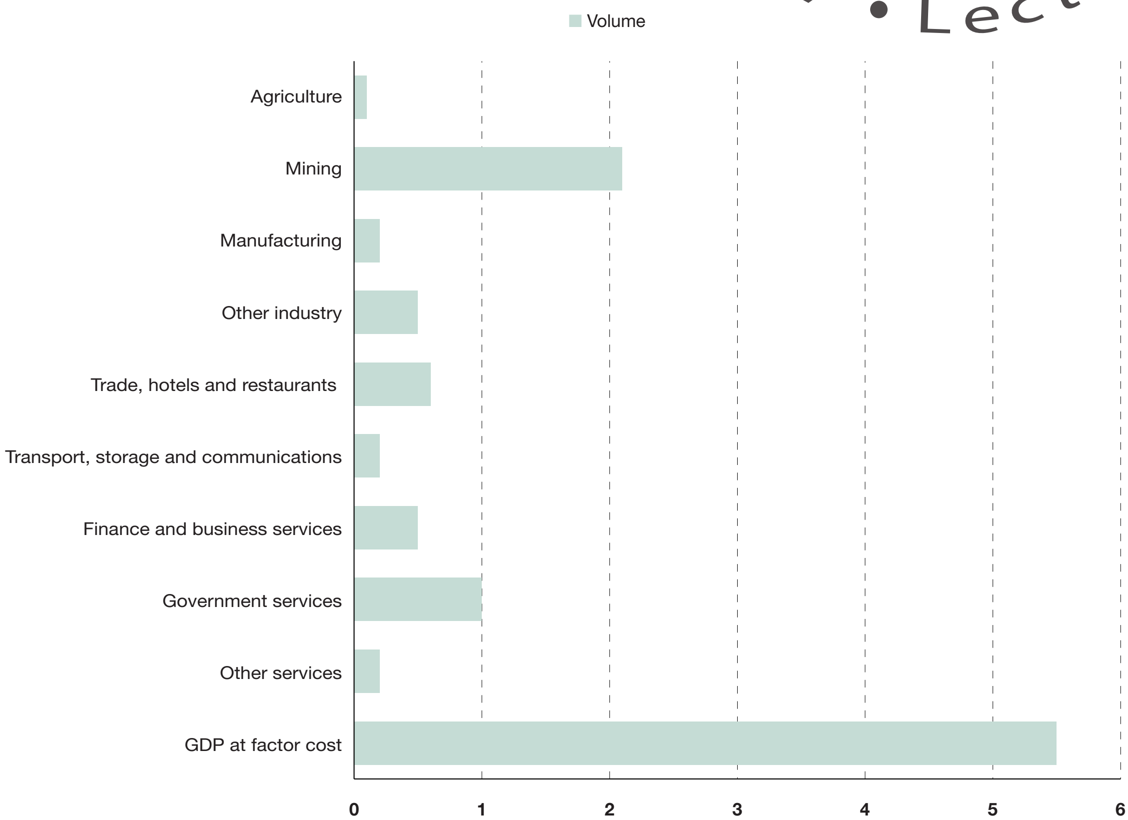
1. The national accounts data cover the period July-June and the fiscal data cover April-March, while balance-of-payments and monetary data are based on the calendar year.

Figure 3 - **GDP by Sector in 2002/03** (percentage)



Source: Authors' estimates based on Bank of Botswana data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2002/03** (percentage)



Source: Authors' estimates based on Bank of Botswana data.

1970s, declined steadily to 4.7 per cent in the 1990s and 3.7 per cent in 2003/04. Clearly, this declining trend is inconsistent with the country's hopes and expectations of nurturing a vibrant and diversified economy, as within the manufacturing sector itself very little diversification has occurred. Despite the government's investment promotion drive, through the Botswana Export Development and Investment Agency (BEDIA), the manufacturing sector consists of a narrow range of activities, including the traditional meat and meat products industry, brewery, textiles and garments, tannery and leather products, glass and information technology products.

The financial services, trade, and hotels and restaurants sub-sectors have seen their contributions to GDP rise steadily over the years, reflecting their response to the expansion of the booming tourism industry. Tourism, which contributes nearly 4 per cent to GDP, is Botswana's second-largest export sector behind diamonds, bringing around 1.1 billion pula into the country annually. In 2003/04, a new tourism model, grounded in community-based projects, was introduced throughout the country. This was designed to attract a more diverse group of tourists and benefit the rural communities in which most tourism properties are located. The strength of Botswana's tourism industry is underscored by the listing of two tourism firms, AfriTourism Limited and Chobe Holdings, on the Botswana Stock Exchange. Another company, Okavango Wilderness Safari (OWS), received approval last year to join Botswana's International Financial Services Centre (IFSC). Another noteworthy feature of the services sector is the growth in the telecommunications sub-sector, particularly cellular phones. During 2003/04, the sector maintained the growth momentum it gathered in the preceding year, with mobile telephone services growing by over 10 per cent. It should be added, however, that reforms in the financial services sector constitute an integral part of the government's diversification strategy. The partial privatisation of the pension fund and the recent launching of an offshore centre are key financial services reforms that may have important implications for the conduct of monetary policy.

Despite the surge in oil prices, Botswana has witnessed strong growth in domestic demand. In 2003/04, total gross domestic investment accounted for 25.5 per cent of GDP, compared with 24.5 per cent in 2002/03. The increase was due to growth in private investment, however, as public investment was scaled back owing to revenue shortfalls. Domestic consumption increased as well. Gross national savings, which accounted for over 45.3 per cent of GDP in 2002/03, fell slightly to 37.2 per cent in 2003/04. Here again, the decline was due to a decrease in public savings.

Macroeconomic Policies

Table 1 - **Demand Composition** (percentage of GDP)

	1996/97	2001/02	2002/03	2003/04	2004/05(e)	2005/06(p)	2006/07(p)
Gross capital formation	**26.0**	**24.7**	**24.5**	**25.5**	**27.2**	**29.1**	**30.7**
Public	13.9	11.7	11.1	11.2	11.4	11.5	11.5
Private	12.0	13.0	13.4	14.3	15.8	17.5	19.2
Consumption	**56.5**	**62.1**	**54.7**	**62.8**	**62.5**	**61.9**	**62.0**
Public	26.6	33.0	34.7	37.3	37.7	37.6	37.8
Private	30.0	29.1	20.0	25.5	24.7	24.3	24.2
External sector	**17.5**	**13.3**	**20.8**	**11.6**	**10.3**	**9.0**	**7.3**
Exports	55.7	49.1	49.2	44.6	43.6	43.2	41.7
Imports	-38.2	-35.8	-28.4	-32.9	-33.3	-34.2	-34.5

Source: Bank of Botswana and IMF data; estimates (e) and projections (p) based on authors' calculations.

Fiscal and Monetary Policy

Botswana's National Development Plans set out guidelines for the country's fiscal policy stance. A major objective of fiscal policy is to ensure that public resources are used efficiently and effectively to provide the economic and social infrastructure needed for rapid private sector development, including that needed for economic diversification and the growth of enterprises producing for export.

Following two years of sizeable deficits (in 2001/02 and 2002/03), the government announced its intention to return to a long-standing tradition of surpluses. This will require a boost in non-diamond revenue in the years ahead, as resources from diamonds are expected to plateau along with production, and outlays on education and health, including HIV/AIDS, will need to be increased. In 2003/04, a prudent fiscal policy resulted in a slight surplus. Faced with a shortfall in revenue (mostly due to inadequate collection of the value added tax introduced in 2002), the authorities raised levies on petroleum products and cut capital expenditure. Concurrently, in the context of the partial privatisation of the civil service pension fund initiated in 2001, the government continued to draw on its deposits with the central bank to transfer funds corresponding to accumulated pension claims to the private pension fund managers.

Monetary policy is formulated with the aim of achieving a low, stable rate of inflation while maintaining a stable real exchange rate that supports the international competitiveness of local producers. The tight monetary policy introduced at end-2002 to stem inflationary pressures was relaxed towards the end of 2003 as those pressures abated. The Bank of Botswana (BoB) rate, which was raised from 14.25 per cent to 15.25 per cent in November 2002, was lowered in steps to 14.25 per cent by end-2003 and remained at that level in 2004. The prime rate for commercial banks, however, remained at 15.75 per cent in 2004. The monetary authorities also made extensive use of open market operations to absorb excess liquidity through the sale of Bank of Botswana certificates (BoBCs) in the domestic money market.

Table 2 - Public Finances[a] (percentage of GDP)

	1996/97	2001/02	2002/03	2003/04	2004/05(e)	2005/06(p)	2006/07(p)
Total revenue and grants[b]	**41.7**	**39.7**	**41.0**	**44.8**	**44.5**	**44.3**	**44.1**
Tax revenue	29.3	33.1	35.1	38.6	38.4	38.3	38.1
Grants	0.5	0.2	0.2	0.5	0.5	0.4	0.4
Total expenditure and net lending[b]	**33.9**	**42.7**	**45.0**	**44.5**	**44.8**	**44.9**	**45.9**
Current expenditure	22.4	31.0	33.2	35.1	35.3	35.2	35.4
Excluding Interest	*21.9*	*30.8*	*32.9*	*34.8*	*35.1*	*34.9*	*35.2*
Wages and salaries	7.8	12.3	11.3	10.7	10.5	10.3	10.1
Interest on	0.5	0.3	0.2	0.3	0.3	0.2	0.2
Capital expenditure	12.6	11.6	10.9	10.5	10.6	10.7	10.7
Primary balance	**8.3**	**-2.7**	**-3.8**	**0.6**	**0.0**	**-0.3**	**-1.6**
Overall balance	**7.7**	**-3.0**	**-4.0**	**0.3**	**-0.3**	**-0.5**	**-1.8**

a: Fiscal year begins 1 April.
b: Only major items reported.
Source: Bank of Botswana and IMF data; estimates (e) and projections (p) based on authors' calculations.

In response to the prudent monetary policy of the central bank, inflation declined from 10.7 per cent in 2002/03 to 6.3 per cent in 2003/04, and it remained at about the same level in 2004 despite the February 2004 devaluation of the pula, the oil price hike and the attendant rise in the prices of electricity and petroleum products (6 per cent and 16-19 per cent respectively). Partly reflecting the monetary policy stance, growth in domestic credit decelerated sharply in 2003 and 2004.

Exchange rate policy is directed at achieving an equitable balance between maintaining the competitive position of domestic producers, especially producers of non-traditional exports, and avoiding monetary instability and high inflation. For sustainable economic diversification, the creation of productive employment opportunities and expansion of economic opportunities for Botswana entrepreneurs, it is necessary that greater emphasis be given to maintaining the international competitiveness of domestic producers of exports and tradable goods. Therefore, Botswana's macroeconomic policy aims at maintaining a stable real effective exchange rate (REER) in order to ensure international trade competitiveness. To this end, the exchange rate policy maintains a stable nominal effective exchange rate (NEER) by pegging the pula to a basket of currencies including the Special Drawing Right (SDR) and the South African rand, in proportions that reflect Botswana's trade shares. By promoting the stability of the NEER, the exchange rate mechanism has also acted as a nominal anchor for monetary policy. Between December 2000 and December 2003, the pula appreciated in real terms against the basket of currencies by about 25 per cent, after adjusting for the effect of VAT. It appreciated by 13 per cent against the SDR, 23 per cent against the US dollar and 11 per cent against the British pound, but depreciated by 6 per cent against the rand. Meanwhile, the trade-weighted NEER of the pula remained stable, appreciating by only 0.3 per cent over the same period. On 5 February 2004, the pula was devalued by 7.5 per cent against the basket to offset the steady real effective appreciation over the past three years, in order to improve the economy's external competitiveness by providing an important boost to exporters and domestic producers competing with imports. Tourism, textiles, diamonds, copper, nickel and agricultural products are among the many sectors expected to benefit from the devaluation.

External Position

Botswana has an open economy, with a share of trade (imports plus exports) in GDP exceeding 75 per cent. Exports have been highly concentrated on a limited number of commodities (minerals) and directed at just a few destinations (mostly Europe). In 2003/04, diamond exports amounted to 9.2 billion pula ($1.8 billion), around 80 per cent of total exports. This figure represents a 4.4 per cent increase over the country's 2002/03 diamond exports of 8.8 billion pula ($1.4 billion). During the same period, copper and nickel exports increased significantly in pula terms (by 66 per cent), although they represent a very small proportion of total exports. Imports also grew strongly in 2003/04 despite the devaluation of the pula and high oil prices. In nominal terms, imports increased from 3 366 million pula in 2002/03 to 4 813 million pula in 2003/04, an annual increase of 42 per cent. The 2003/04 balance of payments showed an overall surplus of about 1 000 million pula, compared to a surplus of only 300 million pula recorded in 2002/03. At the end of December 2003, foreign exchange reserves stood at $5.3 billion (SDR 3.6 billion), which, despite a decline of 5 per cent from November 2002, was still equivalent to 26 months of import cover.

The current economic development strategy for Botswana emphasises the advantages of attracting foreign direct investment (FDI) to the country. From 1997 to 2001, total FDI increased by 77 per cent, with the mining sector accounting for the largest share (86 per cent) as well as the bulk of FDI growth. Non-mining FDI grew rather slowly, the important recipients being the finance sector (7.5 per cent of total FDI) and the retail and wholesale trade sector (6.7 per cent), while manufacturing FDI grew relatively slowly and in the construction sector it actually declined over the period.

Botswana's trade policy over the years may have been dictated largely by its membership of the Southern African Customs Union (SACU). Under the SACU agreement, all trade negotiations or agreements between Botswana and third parties must be acceptable to other SACU members. Botswana is also a member of the Southern African Development Community (SADC) and host to the SADC Secretariat. The SADC Trade Protocol, signed in September 2000, envisages the creation of an SADC free trade area by 2005. Botswana is also a beneficiary of the United States' African Growth and Opportunity Act (AGOA), which provides duty-free access to the US market for over 65 000 products from sub-Saharan Africa. Initially, Botswana was excluded from the AGOA protocol because it was classified as a middle-income country. In August 2002, however, the

Table 3 - **Current Account** (percentage of GDP)

	1996/97	2001/02	2002/03	2003/04	2004/05(e)	2005/06(p)	2006/07(p)
Trade balance	18.2	12.4	16.8	13.9	12.6	11.5	10.0
Exports of goods (f.o.b)	51.6	42.1	42.9	38.4	37.6	37.1	35.8
Imports of goods (f.o.b)	-33.4	-29.7	-26.1	-24.6	-25.0	-25.6	-25.8
Services	-4.1	-1.8	-0.2				
Factor income	-3.9	-8.2	-6.1				
Current transfers	3.7	3.9	1.8				
Current account balance	**14.0**	**6.4**	**12.4**				

Source: Bank of Botswana and IMF data; estimates (e) and projections (p) based on authors' calculations.

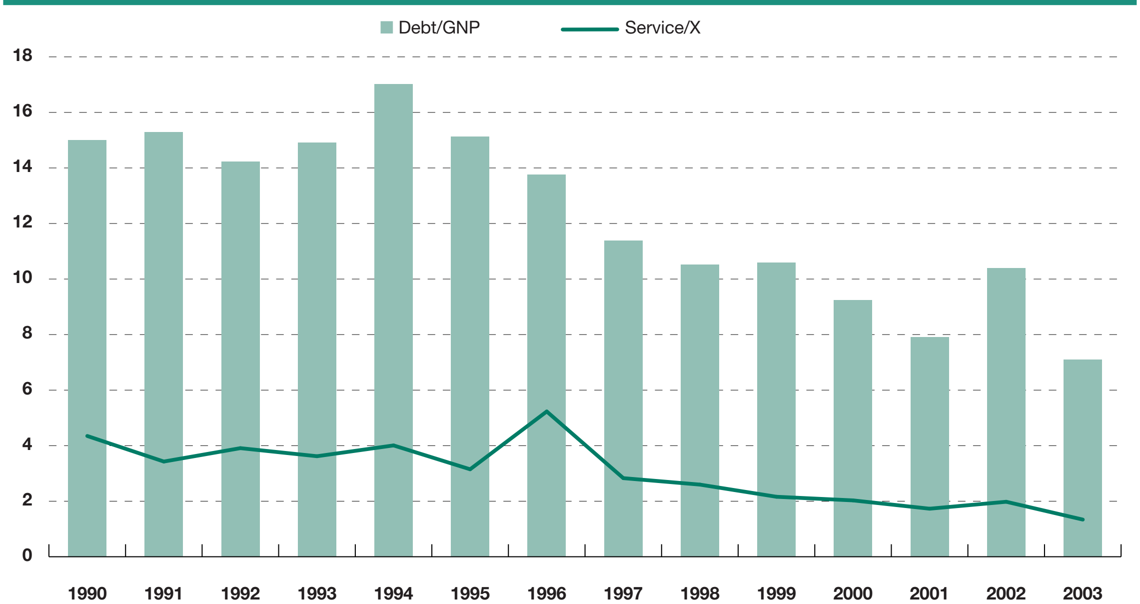
United States amended the AGOA provisions (AGOA II), allowing Botswana's textiles and garments to enter the US market duty-free. Botswana has also benefited from the WTO's Generalised System of Preferences (GSP), a tariff reduction facility offered by industrial countries to designated less-developed countries (LDCs) on certain export products. Foreign investors, especially in the textile sub-sector, have opted to locate their operations in Botswana in order to utilise the country's unused GSP facility and export to the United States.

The phasing out of the Multi-fibre Agreement on textiles and clothing on 31 December 2004 is likely to have adverse effects on Botswana's exports of textiles and clothing despite the GSP and the AGOA arrangements. It is likely that Botswana will be seriously hit for two reasons. First, despite AGOA protection, the end of the MFA will expose Botswana to competition from larger low-cost producers, such as China and India, which can sell their goods at lower prices on the global market. The fragmented nature of activities in the textiles and clothing sector in Botswana means that the country cannot compete effectively with the more efficient Asian producers in terms of unit labour cost, quality and productivity. A study carried out by the WTO in September 2004 shows that with the phasing out of the MFA, India and China alone are likely to grab about 80 per cent of the world market for textiles and clothing. The remaining 20 per cent will have to be shared by the rest of the world, including other highly competitive suppliers like Indonesia, Thailand and Pakistan. This means that little market share will be left for African countries such as Botswana and Mauritius. Second, most participants in the textiles and clothing sector in Botswana and other African countries are Asians who shifted their activities to Africa to jump the quota wall and maximise the market access opportunities provided by the AGOA initiative. With quota-free trade in textiles and clothing, many of these Asian producers have already started to relocate to their own countries, thereby exposing the supply constraints that often characterise production and exports in Africa. This is a wake-up call for Botswana and other African countries to diversify production and to upgrade the quality of their exports.

Structural Issues

Botswana has recently embarked on reforms of its

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

large public sector with a view to improving the efficiency and effectiveness of government services. The public sector employs 44 per cent of formal sector personnel (81 000 civil servants and 12 000 employees in parastatals) and accounts for 17 per cent of GDP, second only to the mining sector. Although the public sector has a considerable presence in Botswana's economy, there are no reserved sectors and no resistant monopolies. The reforms include the adoption of the Performance Management System (PMS), Work Improvement Teams (WITS), Computerised Personnel Management System (CPMS), Organisation and Methods (O&M) Reviews, the Performance Based Reward System (PBRS) and decentralisation. The government has also reorganised and restructured some ministries and departments in order to improve efficiency and effectiveness in service delivery. Part of the reform has led to the establishment of autonomous authorities or boards, working largely on commercial principles. Examples include the Public Enterprise Evaluation and Privatisation Agency (PEEPA), the Public Procurement and Asset Disposal Board (PPADB), the Botswana Export Development and Investment Authority (BEDIA), the Citizen Entrepreneurial Development Agency (CEDA) and the Local Enterprise Authority (LEA). As of November 2004, all ministries and independent departments had developed their strategic plans and annual performance plans, in line with the PMS requirements. The process of introducing the PMS at the level of local authorities, which is considered to have greater impact on overall government service delivery, is moving gradually forward. The mainstreaming of PMS in the central government is expected to be completed during the 2004/05 financial year. In the case of WITS, around 565 facilitators and over 2 500 team leaders have been trained under the scheme. In addition, more than 16 WITS awareness sessions have been held for top managers, while 1 000 of the planned 1 150 teams have been registered. Over 700 projects have been undertaken and more than 400 completed.

Enforcing market discipline and promoting efficient allocation and use of economic resources, through the encouragement of private sector involvement in the country's economic development, has been one of the key aspects of public policy and public sector reform agenda in Botswana. With the promulgation of a comprehensive privatisation policy (Government Paper No. 1 of 2000), a new body called the Public Enterprise Evaluation and Privatisation Agency (PEEPA) was set up. Since its establishment, PEEPA has undertaken a review of the operations and activities of government departments and public enterprises, and has developed a draft Privatisation Master Plan which provides the framework and guidelines for the implementation of reforms to increase private sector participation in the economy. In addition, PEEPA has developed guidelines and manuals, including the Contracting Out Guidelines and the Divestiture Procedure Manuals, to help managers of public institutions implement privatisation in a consistent, transparent and equitable manner. Plans are also under way to introduce PPP procurement guidelines. In anticipation of government approval of the draft Privatisation Master Plan and increased activity in the coming year, PEEPA has been recruiting more personnel to boost its human resource capabilities. Throughout 2004, PEEPA has intensified its public awareness campaign, both through the press and by hosting a series of workshops with key stakeholders.

Government has done much to create a sound business environment through provision of infrastructure and enactment of laws and regulations to facilitate the operations of the private sector, as well as a stable macroeconomic environment. All these services are provided through consultations with all stakeholders. The government plays the role of a facilitator and has given the private sector the lead in developing the economy. It has established a High-Level Consultative Council (HLCC) for public-private sector dialogue, chaired by the President himself and having as members all the cabinet ministers as well as private sector actors. The Council meets twice a year to review issues of economic and socio-political importance. Similarly, each ministry has a Ministerial Consultative Forum, which also addresses cross-cutting issues. Finally, there is the national consultative council on manpower and employment, another public-private sector initiative, which reviews issues relating to training and development.

Botswana has long realised the importance of small and medium-sized enterprises (SMEs) in fostering economic growth and creating jobs. This has led to the introduction, over the last two decades, of targeted financial support as well as advisory programmes to help the people of Botswana establish their own enterprises. In their initial stage, these programmes were set up more in response to specific problems encountered than as the basis of a comprehensive and more focused government policy on SMEs. It is estimated that there are about 56 300 SMEs currently operating in the country, employing 125 000 people, including business owners[2]. In a 1996 study of the role of SMEs in Botswana, these enterprises' contribution to GDP was estimated at 30-45 per cent, while that of large firms was estimated at 38-48 per cent of GDP. SMEs are believed to account for 15 per cent of formal employment, implying that job creation is one of their most important contributions.

The Botswana authorities affirm that, in contrast to most other African countries, lack of finance has not been a bottleneck for SMEs in Botswana, as the government made resources available to these firms through its various enterprise development programmes (see box on next page). In particular, the government established two financial schemes – the Micro Credit Scheme and the Credit Guarantee Scheme – to provide citizens with easy access to start-up capital. SME development has suffered from other problems, however, including lack of premises, excessive laws and regulations, lack of information on government assistance programmes, lack of business start-up training and lack of entrepreneurial "role models". As a result, the survival rates of SMEs in Botswana have not been encouraging. Approximately 80-85 per cent of small enterprises in Botswana cease trading within five years of start-up. In addition, few SMEs have managed to grow and make the transition from SMEs to larger enterprises (only one or two out of 100 SMEs succeed in doing so).

To respond to these challenges, the authorities adopted a National Policy on Small, Medium and Micro Enterprises, which was drafted in 1999 by a Task Force on SMEs led by the private sector. The objectives of the policy are to foster citizen entrepreneurship and empowerment; encourage the development of a competitive and sustainable SME community; achieve economic diversification; create sustainable employment opportunities; promote exports; promote the development of vertical integration and horizontal linkages in primary industries (agriculture, mining and tourism) for SMEs; and improve efficiency in the delivery of products to business. An appropriate institutional framework and mechanisms for the implementation of the policy were put in place through the establishment of the Citizen Entrepreneurial Development Agency (CEDA). CEDA seeks to develop sustainable citizen-owned businesses through the provision of finance and the development of business skills. It offers three forms of assistance: *i)* financial assistance in the form of loans to citizens at subsidised interest rates, aimed at assisting those who wish to start or expand their businesses; *ii)* a training, monitoring and mentoring programme for SMEs; *iii)* a venture capital fund launched in September 2003 to provide risk capital to citizen-owned projects and/or joint ventures between citizens and foreigners. In all cases, the business owner is encouraged to contribute to the project cost in the form of equity or an owner's contribution so as to share the risk. The contribution may be in cash, in kind or a combination of the two. Small and medium-scale projects may be assisted even if the owner cannot raise a contribution.

In October 2004, the government inaugurated the board of the Local Enterprise Authority (LEA) and the

2. There are *i)* approximately 50 000 micro-enterprises (with fewer than six workers including the owner and annual turnover of less than 60 000 pula), of which 70 per cent are located in rural areas; 65 per cent of them are involved in trading, 25 per cent in manufacturing and about 10 per cent in other sectors; about 75 per cent of the micro-enterprises are owned by women, lack formal registration and operate from residential premises; *ii)* about 6 000 small enterprises (with fewer than 25 employees and annual turnover of 60 000 to 1 500 000 pula), of which 80 per cent are located in urban areas; approximately 40 per cent of small enterprises are in the services sector, 20 per cent in manufacturing, 16 per cent in retailing, 10 per cent in transport/distribution, 6 per cent in construction and 8 per cent in agriculture; and *iii)* about 300 medium-sized enterprises (with fewer than 100 employees and annual turnover of 1 500 000 to 5 000 000 pula), mostly involved in manufacturing activity.

Experiences in Financing SMEs: From FAP to CEDA

Entrepreneurs generally identify access to capital as their greatest challenge. In the case of Botswana, however, financing appears to be less problematic as the government has been providing adequate financial resources or guarantees to those intending to start up businesses. The policy of financing SMEs with 100 per cent government grants began in earnest in 1982 with the establishment of the Financial Assistance Programme (FAP). Prior to this period, several schemes had been introduced to provide government support to SMEs, such as the Botswana Enterprise Development Programme, the Rural Industrialisation Programme and the Business Advisory Service, but the failure rate was almost 100 per cent. In response, the FAP was introduced as an incentive and subsidy policy aimed at creating employment opportunities and encouraging investment in a range of economic activities. Its original intention was to stimulate investment in sustainable economic activities that would produce either exports or import substitutes. The FAP has been regularly reviewed and evaluated (in 1984, 1988, 1995, 2000), and appropriate reforms have been carried out in response to these evaluations. One of the criticisms of the FAP, just like its predecessors, is that it was giving free money to people without scrutiny. In addition, the massive administrative problems and the grant element of the scheme provided incentives for fraud and abuse. As a result, the review in 2000 concluded that the FAP was no longer effective in achieving its objective of promoting sustainable employment creation. Although some jobs were created as a result of the FAP, the cost of creating them was unsustainable and unacceptably high. The review also concluded that the FAP was inappropriate to 21st-century Botswana and that it was not addressing the main constraints to investment and the development of sustainable productive enterprises. The review therefore recommended that the FAP should be replaced with alternative forms of support for effective promotion of SMEs.

In 2001, the FAP was replaced by CEDA. Unlike its predecessors, CEDA provides financial assistance to SMEs in the form of subsidised loans (not grants) and risk sharing, although no collateral is required from beneficiaries of this scheme as long as they are citizens. The scheme is meant to be a soft window for citizens wishing to start a business or expand existing operations. CEDA also focuses on entrepreneurial and management training, monitoring and mentoring. This is important because adequate financing without the necessary knowledge and skills may result in a high rate of business failure. Very few Botswana citizens have the requisite education and training in business management and entrepreneurship. After independence, the school system did not help matters either, as it was heavily biased against self-employment. Instead, it churned out people prepared only for civil service employment. Moreover, government taxation and other policy measures promoted cattle farming as a comparatively low-risk, high-return form of investment, which introduced an inherent bias against SMEs. As a result, relatively few Botswana citizens engaged in business apart from highly fragmented, small-scale agricultural activities. Although CEDA has overcome some of these apparent weaknesses of SMEs in Botswana, the business failure rate is still high, albeit with a few success stories notably in the services industry, and particularly in the transport and information technology sub-sectors.

Small Business Council (SBC). The LEA is to provide assistance to SMEs in the preparation of business plans, feasibility studies and market surveys. It also aims to improve the business skills and competence of SME entrepreneurs through the provision of training and advisory services in entrepreneurship development, technology and marketing, and to identify SME firms with export potential and help them enhance their productivity and competitiveness for export markets. In addition, the LEA seeks to promote business linkages between SMEs and big industries, including the purchase of locally produced goods and services by larger firms, as well as to facilitate and co-ordinate the provision of infrastructure and facilities such as factory shells and working space. The SBC is to act as an advisory body that will have a consultative role regarding policy as it affects small business in Botswana. In this regard, it is expected to examine policies and procedures as they stand, with a view to identifying all policy constraints and impediments to the growth of the SME sector. In a further move to facilitate the development of local entrepreneurship, the President, in his State of the Nation Address on 8 November 2004, declared that by March 2005 a total of eight SME pilot clusters would be established to promote productivity growth through internal competition and economies of scale.

Political and Social Context

Botswana is the longest-lived democracy in Africa. The country holds elections every five years, and its ninth free and fair elections were held on 30 October 2004. The democratic process is enriched by the plurality of political parties, of which there are currently 12. The ruling Botswana Democratic Party (BDP), however, continues to hold a majority of seats in Parliament, fuelling the continuing fear of lack of proportional representation in Parliament. Such concerns eased greatly when the opposition parties made substantial gains in the 2004 election, winning 13 out of the 57 seats contested and leaving the ruling BDP with a sweep of 44 seats. Female participation in politics is encouraged at all levels in Botswana, even though in the October 2004 presidential and parliamentary elections, only four out of 57 elected MPs were women, while five of the recent appointments to cabinet are women (gender-related issues are discussed in detail below). The public sector has shown ample take-up of this important aspect of good governance. A full-fledged department dealing with gender development was established long ago in the Ministry of Labour and Home Affairs in order to co-ordinate gender development efforts in the country.

Botswana is rich, and at the same time very poor. Despite its macroeconomic success, Botswana has serious problems of poverty and high unemployment compared to countries at a similar level of economic development. It has been argued that the poverty situation in Botswana appears to be more of a structural problem, attributable to a rather narrow economic base which tends to limit opportunities for employment, a poor endowment of agricultural resources, a small and sparsely distributed population (1.7 million in 2001) and a very small and fragmented domestic market. It has also been posited that many of the poverty reduction programmes have not achieved the expected results due to a lack of effective co-ordination among different government departments, inadequate monitoring and evaluation of programmes, and insufficient participation by the poor in programme design, implementation, monitoring and evaluation. Recent statistical data (2003) show that the proportion of the population living below the poverty line in Botswana has declined to 30 per cent, from 59 per cent in the 1980s, owing to the government's national poverty reduction strategy. Given the high per capita income of this diamond-rich country, however, this is still considered to be too high. A related problem is unemployment, which is estimated at nearly 20 per cent of the labour force. The high unemployment rate may be attributed to a number of factors. First, the mining sector, which is the backbone of the economy, is an enclave that is unable to absorb the teeming numbers of unemployed due to its capital intensity. Second, many people engaged in the traditional agriculture sector have been forced to abandon this activity as a result of incessant problems of bad weather and disease. It should be noted that the Kalahari region of Botswana is prone to recurring drought and harsh weather, and the country has in the past experienced severe outbreaks of diseases such as cattle lung disease and foot and mouth disease, with devastating consequences on cattle herds and the beef industry. Third, the education system is not producing people with the right skills mix to be gainfully employed, particularly in the private sector, which has become increasingly skill-intensive. A number of new measures are being taken to address poverty and unemployment issues in Botswana. The government has set up a committee to submit a comprehensive progress report on the implementation of its Poverty Reduction Strategy Paper. Additionally, a total of 16 programmes estimated to cost 165 million pula are included in NDP9 under the respective sectoral projects of the concerned ministries. It is planned that in 2005 a poverty reduction programme advisor will be attached to the Ministry of Finance and Development Planning to oversee the poverty strategy programme. According to a recent UNDP Status Report publication on progress towards the Millennium Development Goals (MDGs), Botswana is on track to halving the proportion of people below the $1 per day poverty line by 2015.

Another major challenge facing Botswana is the devastating impact of the HIV/AIDS pandemic. The high prevalence rate of HIV/AIDS continues to reduce the capacity of some of the most productive members of society, thus affecting both employment and growth. This has already started to reverse some of the hard-earned economic and social gains of the past decades, as reflected in a lowering of life expectancy rates. The first case of HIV-related illness in Botswana was diagnosed in 1985. Since then, the virus has spread rapidly from urban to rural areas, leaving no district spared. During the 1993-2002 period, HIV spread rapidly among all age groups and the prevalence rate more than doubled, reaching 35.4 per cent at the end of the period. This figure, however, masks wide variations between genders and regions; in 2002, for instance, HIV prevalence among pregnant women by health district ranged from 27 per cent in Kweneng West district to 52.2 per cent in Selibe/Phikwe.

Botswana, supported by the international community, has devoted considerable resources to fighting the disease. The government is committed to giving high priority to combating the pandemic by designing and implementing appropriate medium- to long-term programmes. Through the National AIDS Co-ordinating Agency (NACA), the authorities recently prepared a comprehensive National Strategic Framework (NSF) for HIV/AIDS that consolidated all existing programmes related to the pandemic and established new programmes to prevent HIV transmission and to mitigate the impact of HIV/AIDS. This strategy is considered to be among the best in Africa. The government has increased budgetary allocations to the HIV/AIDS programme to 6 per cent of the total budget. In December 2003, 17 voluntary counselling and testing centres were up and running in the country, and some 100 000 people had made use of these services. Furthermore, over 11 450 patients were on antiretroviral (ARV) treatment. In addition, under the Prevention of Mother-to-Child Transmission (PMTCT) programme, as of February 2004, 11 329 pregnant women had received counselling, 71 per cent or about 8 000 of the mothers who received counselling were tested for HIV, 30 per cent of those tested were HIV-positive, and 1 697 were already being treated with the antiretroviral drug AZT. In addition, 1 543 infants who were found to be HIV-positive after birth were given AZT. The target of the government is to increase PMTCT uptake from 28 per cent of HIV-positive pregnant women to 50 per cent by March 2005. Routine voluntary HIV testing also started at the beginning of 2004 as part of an effort to address the stigma associated with HIV/AIDS. To complement the government's efforts, the Global Fund, an American non-governmental organisation, recently approved an $18.5 million fund to be used over a two-year period to assist in prevention, care and support actions targeting HIV/AIDS. This initiative will support the establishment of alternative care models such as hospices, day care centres and community-based counselling centres. National, bilateral and multilateral agencies continue to provide technical and financial support to efforts to address the HIV/AIDS pandemic in Botswana. The government is hopeful that it will halt the spread of HIV/AIDS and reverse the trend by 2015.

Other cross-cutting issues related to progress towards some of the MDGs, including universal education, gender mainstreaming and environmental sustainability. Botswana has already achieved the 100 per cent target for primary school enrolment and a 100 per cent transition rate from primary education to junior secondary education. Secondary school enrolment is currently above 90 per cent, and the immediate focus is on achieving an enrolment rate of 100 per cent within the next few years. The government is also striving to improve the overall quality of education at all levels, with strong emphasis on technical, management and vocational education. Botswana has already eliminated gender disparity in primary and secondary education. The net school enrolment ratio for girls is greater than that for boys, and Botswana is the only African country where the female literacy rate exceeds that for males. In view of all these remarkable statistics, one would have expected a much higher gender development index (GDI) for Botswana. The latest available GDI for Botswana is 0.581 for the year 2002, a score lower than that of countries such as Mauritius (0.778), Cape Verde (0.709), Equatorial Guinea (0.691) and South Africa (0.661). Moreover, the current involvement of women in economic and socio-political activities does not reflect the real progress made on the education and literacy fronts. As stated earlier, Botswana has only four women out of 57 MPs and five women out of 17 cabinet ministers. In terms of public sector employment, the figures are much more encouraging but still fall short of expectations: in 2003, women accounted for around 46 per cent, 39 per cent and 38 per cent of the total number of employees in central government, parastatals and local government respectively. Women are relatively disadvantaged in terms of access to social services and economic opportunities such as access to arable land and command of resources. They are also disproportionately afflicted by the HIV/AIDS pandemic. It is noteworthy, however, that the government, through its Vision 2016 and the NDP9, has initiated a comprehensive national programme towards increased gender mainstreaming in all spheres of the economy.

In the field of environmental protection, Botswana has sufficient water resources, particularly in the northern part of the country, to sustain a variety of wildlife. Water is also being tapped through the North-South Water Carrier pipeline to meet the domestic and industrial needs of the more urbanised South. The country faces two main problems: that of over-grazing and soil erosion in the western part of the country, with its attendant consequences for the ecosystem and agricultural development; and that of household waste and air pollution. The government is, however, committed to integrating environmental issues into development policies and programmes.

Burkina Faso

key figures

- Land area, thousands of km^2 274
- Population, thousands (2004) 13 393
- GDP per capita, $ (2003) 328
- Life expectancy (2000-2005) 45.7
- Illiteracy rate (2004) 72.5

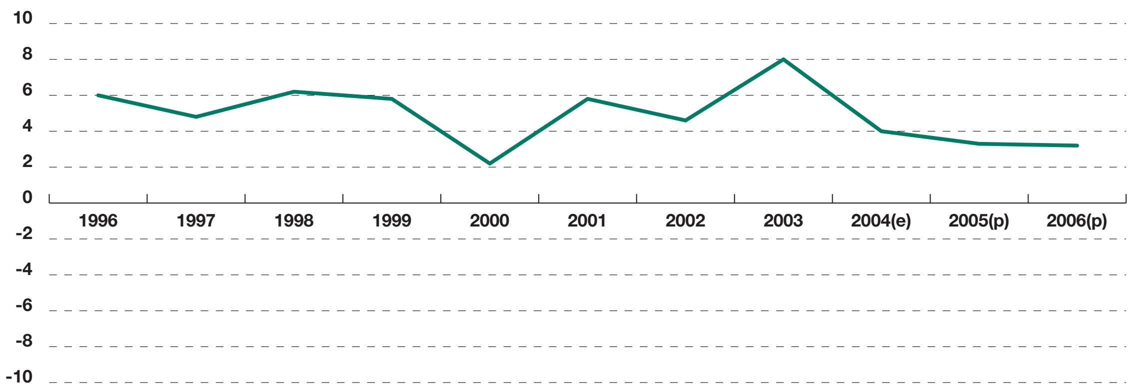
BURKINA'S VERY HIGH GROWTH RATE of 8 per cent in 2003 showed the economy's resilience in the face of the worsening crisis in neighbouring Côte d'Ivoire, even if part of it was due to one-off factors such as excellent cotton and record cereal harvests. An external shock of this kind should have had not only economic consequences (from closure of the trade corridor through Côte d'Ivoire, congestion and premature deterioration of roads and fewer remittances from Burkinabè workers abroad) but also social fall-out caused by the large-scale return home of mostly impoverished expatriate workers.

The government and the private sector adapted to the situation, however, coming up with practical solutions and calling on regional solidarity. It was a display of the quality of institutional development in one of Africa's poorest countries and was recognised by the technical and financial partners, who give Burkina Faso strong support.

A return to more modest growth (4 per cent) in 2004 and relatively poor prospects for 2005 (3.3 per cent) are a reminder the country is still very little diversified, with very few comparative advantages, and that its social and economic development (which is fairly slow, even disappointing) is very vulnerable to the weather, insects, terms of trade and the euro/dollar exchange rate. The challenge for Burkina Faso is to diversify economically to reduce this vulnerability and make more use of growth to reduce poverty.

Deterioration in the terms of trade has made cotton prices unpredictable.

Figure 1 - **Real GDP Growth**



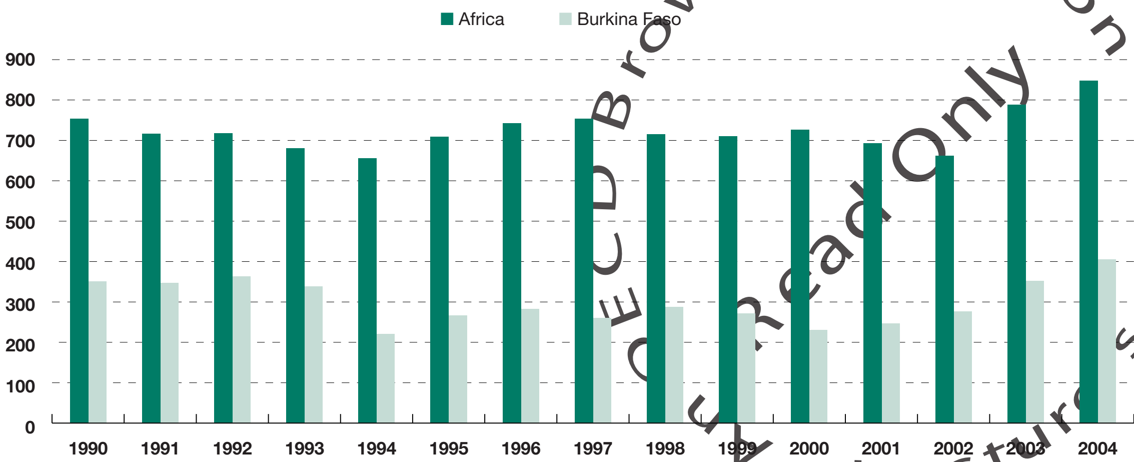
Source: Data from the IMF and domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent Economic Developments

The primary sector (31 per cent of GDP in 2003 and occupying 80-90 per cent of the workforce) expanded by 10.7 per cent in 2003 and was the engine of national growth, but is expected to shrink by 2.7 per cent in 2004.

This development is mainly due to an estimated 14 per cent drop in cereals production in 2004 after a big rise of 16.3 per cent in 2003. The very sharp fall in cereals prices after the excellent 2003 harvest may have contributed by pushing farmers to switch to other cash crops, mainly cotton. But the chief reason was almost certainly lack of rain, especially in the north,

Figure 2 - **GDP Per Capita in Burkina Faso and in Africa** (current $)



Source: IMF.

and its uneven distribution. Damage done by desert locusts should not be exaggerated, since it was mainly in the north, which yields only a small part of the cereals harvest, especially in a drought year like 2004.

However, though lower, the national output of 3.1 million tonnes (2.6 million available) in 2004 was still enough for local consumption (2.45 million). Surpluses expected in the main growing regions should make up for the shortfall in the north, but the primitive structure of the domestic market makes sending them there a difficult matter. The cereals sector lacks organisation and proper storage, marketing and export facilities.

The cotton harvest was again very good in 2004/05 and was expected to be between 560 000 and 570 000 tonnes after the 480 600 tonnes of 2003/04 which, with good prices and movement of the crop not too big a problem despite the closed Ivorian border, enabled the cotton marketing monopoly Sofitex to pay growers a large bonus[1] in 2004/05. The sharp rise in the price to growers (210 CFA francs/kg compared with 185 in 2003/04) very probably partly accounted for the 11.8 per cent increase in land under cotton. Yields were also up about 6 per cent.

The sector reached an important milestone in July 2004 when Sofitex handed some of its marketing operation over to two foreign firms – Socoma, a subsidiary of the French firm Dagris, in the Fada N'Gourma region, and Faso Coton, a subsidiary of the Swiss firm Paul Reinhart, in the Ouagadougou area. But Sofitex still controls 85 per cent of cotton sales nationwide. The switchover did not involve layoffs and both firms seemed to perform well in their first season.

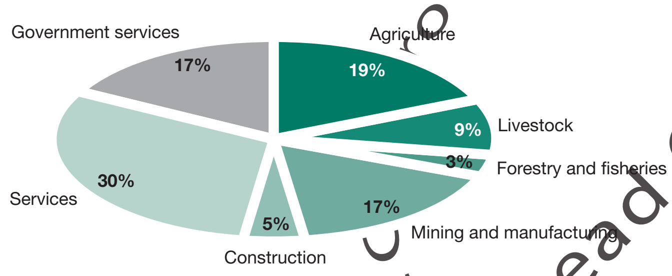
The partial reopening of the border with Côte d'Ivoire, as well as the reorganisation of Burkina's trade to pass through other countries, led to a 20 per cent increase in livestock exports and the sector grew about 2.5 per cent in 2004. Associated activity in the north offset some of the losses from the bad cereals harvest there.

The agriculture sector may have another difficult year in 2005 mainly because of the drop in world cotton prices since mid-2004. The 2004/05 harvest is far from being all sold through futures contracts (which can also be reversed) and Sofitex has temporarily pulled out of the market, banking on a recovery in world prices.

It already seems clear Sofitex will suffer losses anyway when the 2004/05 harvest is sold since the price (excluding the bonus) it pays to growers is much higher than the world price. So it will not be able to

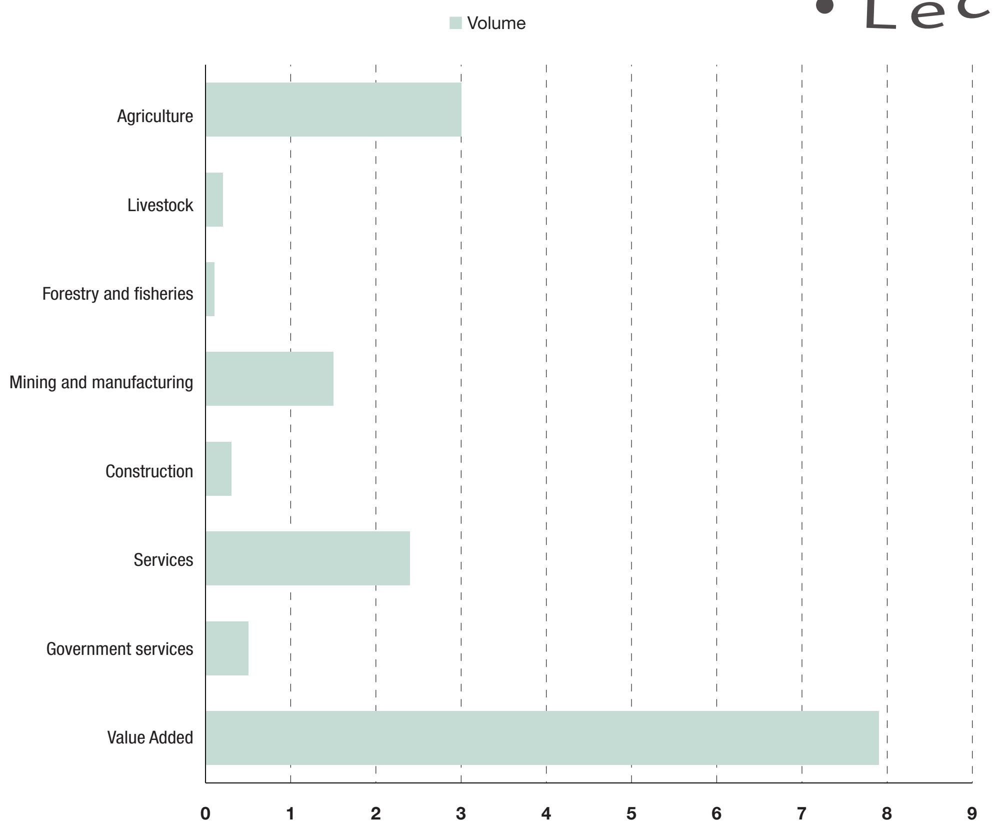
1. The bonus is a share in the proceeds of the harvest in t-1 added to the guaranteed price to the grower for the harvest in t.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates, based on data from the ministry of finance and budget.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates, based on data from the ministry of finance and budget.

offer growers a bonus on the 2005/06 price and may even try to negotiate a no-bonus price much closer to the world price. Because of the growers' production costs, a sharply lower price could put them off sowing a new crop in 2005, so a substantially smaller 2005/06 harvest cannot be ruled out.

Good prices for gold have kept prospectors busy in the large-mine sector and the new mining law has made the sector more attractive. A total of 170 exploration permits have been granted, many in 2004. The mines at Kalsaka (Cluff Mining) and Taparko (High River Gold) are being built and should start to produce in 2005 or early 2006. Other sites are being explored and may be ready to produce in two or three years' time,

Figure 5 - **Cotton production and prices in Burkina Faso**

Note: Production and farmers' prices are based on cottonseed over a growing season. The world price is for cotton fibre, so it has been converted into the equivalent of cottonseed at a conversion rate of 42 per cent and is the average price over a calendar year (year n+1 for a crop in n/n+1).

Source: Ministry of the economy and development and World Bank.

including those at Mana (Semafo) and at Essakane (Orezone), potentially one of Africa's biggest gold deposits (55.6 tonnes) but technically difficult to exploit.

The government's priority is developing large mines but it also wants to develop the small mine sector, which is losing ground but on some estimates provides a living for up to 50 000 alluvial miners and their families. The scheduled privatisation of the national precious metals board CBMP, which handles regulation, production and marketing, is a sign the government wants to revive the sector. Alluvial mining production (hard to measure because of fraud) is about 400 kg a year.

The secondary sector (including extractive industries) was only 22 per cent of GDP in 2003 and is mainly cotton ginning, agri-business and construction. The effect of the Ivorian crisis on the Burkinabè economy and its industry in particular seems to be limited despite higher transport costs. Big firms in the southwest, such as the Grands moulins du Burkina flour mill, Sosuco (sugar), Sitec (vegetable oils) and the Société africaine de pneumatique tyre factory (which uses Ivorian rubber), were badly affected however.

On the whole, the business sector quickly adapted when the Côte d'Ivoire crisis worsened in 2002 by using alternative routes to the sea, shipping goods through the ports of Lomé (Togo), Cotonou (Benin) and Tema and Takorady (both in Ghana). The secondary sector, which grew 6.9 per cent in 2004 (9.5 per cent in 2003) was carried forward by strong ginning activity as a result of the good 2003/04 harvest. The construction industry was also very robust due to major urban building activity such as the Zaca neighbourhood in Ouagadougou.

The services sector (47 per cent of GDP in 2003) was the only one to see growth accelerate in 2004 (6.8 per cent, compared with 6 per cent in 2003). This was because of the vigorous mobile phone sub-sector and also transport, which was partly due to closure of the Ouagadougou to Côte d'Ivoire railway line and the need to find alternative routes. Burkina Faso also

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Gross capital formation	**25.5**	**19.6**	**18.6**	**18.8**	**20.6**	**20.9**	**21.6**
Public	12.6	12.8	10.9	9.2	10.6	10.8	11.1
Private	12.9	6.8	7.7	9.6	10.0	10.2	10.5
Consumption	**92.3**	**94.2**	**94.1**	**93.2**	**91.0**	**93.1**	**93.8**
Public	14.7	22.6	22.1	20.9	21.6	22.0	21.6
Private	77.5	71.6	72.0	72.4	69.5	71.2	72.2
External sector	**-17.8**	**-13.8**	**-12.7**	**-12.1**	**-11.7**	**-14.1**	**-15.4**
Exports	11.0	9.2	9.0	9.0	10.3	9.0	7.9
Imports	-28.8	-23.0	-21.7	-21.1	-22.0	-23.1	-23.4

Source: Data from the ministry of finance and budget; estimates (e) and projections (p) based on authors' calculations.

benefited from the informal trade that developed with the rebel-controlled areas of central and northern Côte d'Ivoire after the *de facto* splitting of the country into two.

The very good primary sector results gave the country 8 per cent growth in 2003 but the sector's levelling-off, especially with the drop in cereals production, should slow growth to about 4 per cent in 2004. During 2004, public investment (up about 15 per cent) and private investment (plus 5 per cent) were much more vigorous than household consumption, which was stable. Weak domestic savings meant the current account balance remained negative and continued to hamper domestic growth. But this negative contribution was less in 2004 as exports rose 13.5 per cent and imports 4.8 per cent.

The sale of the 2003/04 cotton harvest before world prices fell limited the effect on 2004 growth of this significant deterioration in national terms of trade. This will probably not happen in 2005, when the price to growers is expected to fall, and possibly production as well, reducing income from cotton below the levels of the past two years. This decline will only partly be offset by switching to other crops. A big new rise in oil prices could significantly push up the cost of electricity and the pump price of petrol.

Changes in the euro/dollar parity will either ease or aggravate these trends. A new slide in the dollar against the euro would help soften the impact of an oil price rise but would also reduce cotton revenue in CFA francs a little further and make the secondary and services sectors less competitive. But even slightly better cereal harvests after the mixed results of 2004 could prop up individual consumption. So the assumption is that there will be moderate growth of 3.3 per cent in 2005.

Macroeconomic Policies

Fiscal and Monetary Policy

Burkina Faso's expected performance in 2004 suggests it will be hard to meet the West African Economic and Monetary Union (WAEMU/UEMOA)'s goal of convergence by 31 December 2005. As in previous years, the country will not comply with the key primary criterion of having a zero or positive ratio of basic fiscal balance to nominal GDP. This is chiefly because of the light tax burden of 11-12 per cent, which does not comply with secondary criteria of having a tax revenue to GDP ratio of at least 17 per cent and a ratio of wage-bill to tax revenue of less than 35 per cent.

The country's problem of increasing and diversifying its exports means it does not comply with the secondary criterion of having a current external deficit (not counting grants) of under 5 per cent. As in 2003, it should meet the three other primary criteria, because the public debt was 42.5 per cent of GDP at the end of 2004, and the secondary criterion of the ratio of domestically financed investment to tax revenue.

Burkina Faso has been satisfactorily carrying out an International Monetary Fund (IMF) sponsored poverty reduction and growth facility (PRGF) since June 2003 and the IMF's second and third reviews of it were successfully completed by February 2005, when the country had had three loans totalling 13.76 million Special Drawing Rights (SDRs) ($20.9 million) out of a total of 24.08 million SDRs available under the programme.

The 2004 budget deficit (including grants) should be about 3.5 per cent of GDP, less than the originally-planned 5.4 per cent. The draft 2004 budget had included a 35 per cent increase in capital spending (from 9.1 per cent of GDP in 2003 to 11.2 per cent in 2004). Despite a good budgeted investment execution rate (at least in commitments) of nearly 70 per cent in the first nine months, the whole-year increase is not thought to have been more than 15 per cent due to the country's limited capacity to absorb investment. But this rise was still quite strong and capital spending

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Total revenue and grants[a]	**21.3**	**18.0**	**16.8**	**17.7**	**17.6**	**16.2**	**18.4**
Tax revenue	11.8	10.3	10.7	11.0	11.1	11.3	11.5
Oil revenue	8.6	7.0	5.3	5.4	5.2	3.7	5.7
Total expenditure and net lending[a]	**19.8**	**21.9**	**21.3**	**20.6**	**21.1**	**21.2**	**21.5**
Current expenditure	10.6	10.4	11.2	10.5	10.8	10.9	10.8
Excluding interest	*9.7*	*9.6*	*10.4*	*9.8*	*10.1*	*10.2*	*10.2*
Wages and salaries	5.1	4.7	4.6	4.6	4.6	4.7	4.5
Interest	0.9	0.8	0.7	0.7	0.7	0.7	0.6
Capital expenditure	9.2	11.6	10.2	9.1	10.4	10.6	10.9
Primary balance	**2.4**	**-3.0**	**-3.8**	**-2.2**	**-2.8**	**-4.3**	**-2.5**
Overall balance	**1.5**	**-3.9**	**-4.5**	**-2.9**	**-3.5**	**-5.0**	**-3.1**

a. Only major items are reported.

Source: Data from the IMF and the ministry of finance and budget; estimates (e) and projections (p) based on authors' calculations.

was 10.4 per cent of GDP in 2004 (up from 9.1 per cent in 2003). Current spending (10.8 per cent of GDP), especially on wages and salaries (4.6 per cent of GDP), is reckoned to have been stable in 2004.

The collection rate of current revenue (except grants) and of tax revenue under the PRGF, was about 75 per cent by the end of September 2004 and remained in step with GDP to end up at a steady 17.6 per cent of GDP for the whole year. Tax revenue (mainly from cotton) rose in response to the good economic performance in 2003, with personal and company tax, as well as that on goods and services, all performing better.

About 80 per cent of the government's funding needs were met by external sources.

The draft 2005 budget, based on a 3.5 per cent growth prediction, is much the same as the previous one, though it includes an increase in the deficit (including grants) to 5.8 per cent of GDP. Expenditure relative to GDP is stable, but tax revenue is set to rise from 11.3 per cent of GDP in 2003 to 12.2 per cent in 2004 (mainly through better collection). The increased deficit is mostly due to a significant fall in grants.

However the actual deficit may not exceed 5 per cent of GDP (including grants) because of lower spending than budgeted, assuming growth is about 3.3 per cent. But this is not at all certain. Implementation of the budget will have to take account of the expected deterioration of local economic conditions during the year. Growth of under 3 per cent would probably cut into tax revenue (especially from the cotton sector). Several question marks also hang over public spending.

The main uncertainty is about the price of oil and its effect on public finances. The government wants to pass on any price increase to the pump price but the social repercussions of this may be a problem. Cutting taxes on oil products would mean losses for the state oil monopoly and for tax revenue. A new oil price rise could also push the government to increase its subsidy to the state electricity firm Sonabel, which put up its prices for the first time in a decade in October 2004 to pay for the higher cost of its fuel.

A budget subsidy for Sonabel has been negotiated with the Bretton Woods institutions for 2005, based on an expected oil price of $40-$45 a barrel. If it went above $45, Sonabel would have to increase its rates again and/or reduce operating costs. But it may get other subsidies, given that 2005 is a presidential election year.

The government's attitude is also unclear in respect of the state cotton firm Sofitex, which will suffer major losses in 2005 (from sale of the 2004/05 crop) because of the fall in world prices, which are much lower than the 175 CFA francs/kg ex-bonus price to the grower, and could reach nearly 20 billion CFA francs ($37.8 million), about 0.7 per cent of the year's predicted GDP. They could be very large in 2006, too, if the price to the grower stays about the same and is not aligned to the world price.

The government has said Sofitex should be able to cope with the 2005 losses without public subsidies and has so far refused to intervene in negotiations between Sofitex and growers to fix a price for the 2005/06 harvest. But Sofitex may not be able to handle new losses and government help, which could unbalance the budget, may be needed. But, again, 2005 is an election year and excessive government spending cannot be entirely ruled out.

Major progress has been made in boosting tax collection and also in transparency and implementation of public spending. Funding sources have recognised this progress and Burkina Faso was one the first countries to get external aid in the form of budget support. Decentralisation of spending authorisations and payments advanced in 2004, along with customs computerisation. A division was set up at tax headquarters to handle large firms.

Work remains to be done in making budget and taxation matters more transparent and effective. A new system to give taxpayers a single tax identity number has been delayed for technical reasons. Budget implementation needs to be quicker and more transparent (remedying slowness in submitting an accounts settlement bill to the state Accounts Court for auditing, for example, and reducing unauthorised spending). The tax collection rate is still insufficient due to the size of the informal sector and non-payment of taxes by much of the farming sector, especially cotton growers. Monitoring of public debt is still inadequate.

The CFA franc is pegged to the euro, so Burkina Faso's monetary policy, handled by the Central Bank of West African States (BCEAO), depends largely on euro zone monetary policies. The bank lowered its intervention rates by 50 basis points in March 2004 (4 per cent for repo rates and 4.5 per cent for a discount rate at the end of 2004).

The consumer price index fell 0.4 per cent in 2004, largely due to cheaper food (-3.4 per cent) after the very good 2003 cereals harvest. But the cost of transport rose 2.9 per cent and electricity 10 per cent, the first effects on domestic inflation of dearer oil. The strength of the euro against the dollar has so far softened the impact of the oil price rise, but its effect on domestic prices in 2005 will have to be carefully watched. Inflation in 2005 is expected to reach 2.6 per cent because of the big rise in transport costs and come close to the WAEMU limit of 3 per cent.

External Position

Early estimates show Burkina Faso reduced its trade deficit (excluding services) as a percentage of GDP from 8.5 per cent in 2003 to 7.9 per cent in 2004 thanks to a 19 per cent rise in the value of exports due to record cotton sales (+ 23.5 per cent in value and volume) in the first half of 2004, before world prices plummeted. The value of imports grew 8.1 per cent mainly due to higher prices of oil, imports of which were 17 per cent higher by value , but only 2.7 per cent by volume.

Foreign trade figures in 2004 would have been better but for a sharp deterioration in terms of trade from mid-2004. Changes in the dollar/euro parity helped cushion the oil price rise (+ 24 per cent in dollars, + 14 per cent in CFA francs), but it cancelled out the gains from the roughly 10 per cent higher dollar price of cotton at which the 2003/04 harvest was exported. The big deterioration in terms of trade should affect the trade balance in 2005, since the 2004/05 harvest will fetch much less than in 2004 while the price of oil may remain high. The trade deficit may reach 10.1 per cent in 2005.

Burkina Faso has a structural trade deficit because of its low level of exports, which were only about 8 per cent of GDP in 2004 compared with an average 26.5 per cent in other WAEMU countries and comprise only a few mainly agricultural items, such as cotton (63 per cent of exports in 2004) and livestock (13 per cent). So export earnings are very vulnerable to changes in the euro/dollar parity and in the price of cotton, which is very erratic.

Limited diversification is possible (into fruit and vegetables and forestry products such as gum Arabic) but in the short-term the only export diversification in sight, from 2005-06, is development of the large-mine gold sector. The country also has to import a substantial amount of machinery, intermediate goods and oil products.

The geographical pattern of its trade has also changed substantially. Exports to the European Union (EU) measured in dollars fell 5 per cent between 1999 and 2003, while those to Asia grew 13 per cent, mostly due to cotton exports. Burkina Faso's cotton sales to Asia doubled between 1999 and 2003 and Asia bought nearly 68 per cent of the crop in 2003, 36 per cent of it going to China. The EU only accounted for 23 per cent of Burkinabè exports and the WAEMU 8.3 per cent. The source of imports is more stable, with 59 per cent coming from the EU and 16 per cent from WAEMU countries.

The country's goods, services and revenue deficit in 2004 of some 325 billion CFA francs ($614 million, 11.3 per cent of GDP) entails heavy dependence on foreign aid, mostly in the form of grants, loans and debt relief by technical and financial partners. Foreign direct investment only amounted to 10 billion CFA francs ($18.9 million) in 2003 and probably no more in 2004. Formal remittances from Burkinabè working abroad have fallen substantially since the start of the Ivorian crisis, from 44.5 billion CFA francs ($84 million) in 2000 to about 20-30 billion CFA francs ($40-60 million) since 2001. But informal remittances are probably large.

Burkina Faso's great need for external funding, due to its structural weakness and small growth of exports, explains why, after reaching completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in May 2002, the ratio of debt (at net present value – NPV) to exports grew to exceed the 150 per cent limit and was nearly 205 per cent at the end of 2004.[2] The IMF reckons this ratio should slowly fall back below 150 per cent by about 2012-13.

The external debt situation after the HIPC Initiative remains fragile however and highlights the

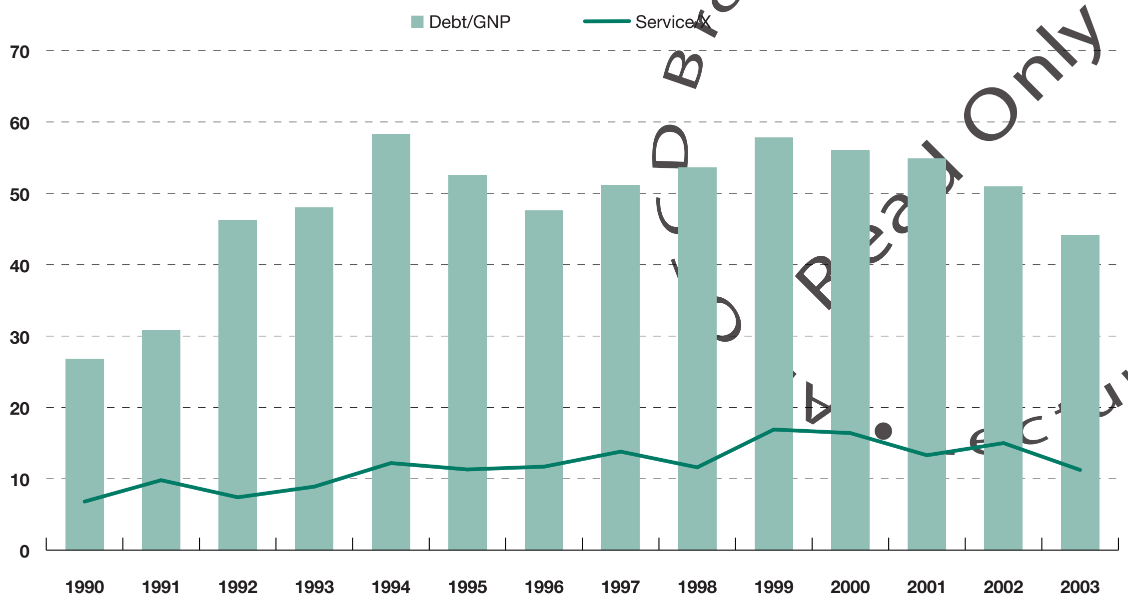
Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Trade balance	-13.3	-10.1	-9.3	-8.5	-7.9	-10.1	-11.3
Exports of goods (f.o.b.)	9.4	7.9	7.6	7.7	9.1	7.9	6.8
Imports of goods (f.o.b.)	-22.7	-18.0	-16.9	-16.2	-17.0	-18.0	-18.1
Services	-6.1	-3.7	-3.4	-3.5			
Factor income	-0.7	-0.9	-0.6	-0.5			
Current transfers	9.4	4.4	4.1	5.2			
Current account balance	**-10.8**	**-10.3**	**-9.2**	**-7.3**			

Source: Data from the BCEAO and the ministry of finance and budget; estimates (e) and projections (p) based on authors' calculations.

2. Much of the increase is due to a fall in commercial interest rates used to calculate the NPV and to the fall in the value of the dollar against the euro.

Figure 6 - Stock of Total External Debt (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

need to boost its concessionality level from the current nearly 56 per cent, as well as to monitor and centralise the government's debt policy better. Certification by the national public debt committee (CNDP) is now needed for any government body wanting to take out a new loan. Increasing exports must be a longer-term priority. External public debt was nearly 945 billion CFA francs ($1.785 billion – 37 per cent of GDP) at the end of 2004 – 87 per cent of total public debt.

The country obtained 16.4 billion CFA francs ($31 million) in debt relief in 2004 from the Paris Club of nations under the HIPC Initiative, but little progress was made in negotiations for similar relief with creditors not belonging to the Club.

Structural Issues

The government continues to modernise and structurally reform key sectors of the economy, though with delays. However, spectacular progress has been made by opening a one-stop business centre to speed up creation of new firms. Procedures have been simplified and new business applications can now be approved in three days instead of a month.

Labour law is also being revised to ease the rules about casual employment (abolishing the monopoly of the ONPE national labour office), redefine the right to strike (limiting strikes to professional reasons) and amend article 637 of the civil procedure code governing compensation for unfair dismissal. Legal decisions can no longer be enforced while an appeal is pending.

However, some measures are being implemented too slowly, such as the new mining law, passed in 2003 and raising great hopes in the sector, especially in respect of its tax clauses, which has still not been put into effect for reasons of gaps in legal procedure and the unfamiliarity of officials with its new terms. The country's business conditions, despite efforts, still suffer from over-costly factors of production, the large size of the informal sector and associated tax and customs fraud, as well as the weak legal structure. There is no commercial court and enforcing court rulings about business matters is sometimes a problem.

The government is trying, with the help of funding agencies, to boost local energy production to reduce one of the most crippling factors of production costs, the high price of electricity. The World Bank approved a $63.58 million grant on 30 November 2004 to help fund, along with other agencies, an electricity development plan (PDSE) to link Ouagadougou and Bobo Dioulasso (338 km distant) and connect the capital to the Ivorian grid by 2007. Plugging into the Ghanaian grid has been put off until 2012.

The PDSE also includes, with World Bank funding, construction of a 14 MW power plant in Ouagadougou which the government says should be ready by March 2005. A 7 MW thermal plant, paid for by a government loan fund to increase supply to the Ouagadougou area, should also come on stream in late 2004 or early 2005. The Ouahigouya power plant should soon provide 3.6 MW now that Sonabel has taken over construction. A Danish government project to provide Ouagadougou with 18 MW of extra thermal power is awaiting approval by the debt approval authorities.

The country's total installed capacity was 172 MW in 2004, 104 MW of it in Ouagadougou. Though 61 centres now have electricity, nationwide coverage will remain very low until these projects are complete. The figure was around 11 per cent in 2003, with huge disparities between urban (57 per cent) and rural areas (2 per cent). Even so, this is an improvement on the 7 per cent coverage in 1999. The government wants to increase it to 15 per cent in 2005 and 60 per cent by 2015.

As noted, Sonabel raised its prices in October 2004 for the first time in a decade, by 10 per cent, in response to dearer oil. The poorest, and businesses, were spared. It was also part of a wider plan to bring Sonabel's rates closer to its production costs, ensure the viability of the electricity sector and cover the cost of the investments it has made. The technical and financial partners want an immediate 28 per cent rate increase, though the long-term aim is to reduce the price with the help of the recent and future investments. Sonabel has commissioned a rate survey that will be done by early 2005.

In the water sector, Ouagadougou is to be connected to the Ziga reservoir by 2007, which should solve the capital's water supply problems.

No major privatisation occurred in 2004, except for the Indépendance hotel and, as mentioned, some of Sofitex's operations. But progress was made in preparing for divestment of some public services privatisation of which is both complex and politically sensitive.

Privatising Sonabel, which began in 2001, moved forward a little in 2004 with the audit of its 2002 and 2003 accounts, completion of analysis of the energy sector and a decision to restructure the electricity sub-sector. The whole operation should be complete in the second half of 2006, when Sonabel will become a holding company, a strategic partner buying most of its capital. The energy sector will be split in two. Sonabel will continue running the present network, with its assets managed by a new government trust company, and rural electrification will be run by the government, NGOs, the private sector and local authorities, partly funded by the FDE development and electrification fund.

Privatisation of Sonabhy, the state oil importing monopoly, is at the same stage as Sonabel's. Audits of its accounts from 2002 to 2004 are underway. The sub-sector analysis has been done and a privatisation plan drafted to open a minority of its capital to private investors. The new firm will keep its monopoly of buying and storing oil products.

The first attempt to privatise the telecommunications firm Onatel produced no acceptable bids. The initial idea was to transfer 34 per cent of its capital to a strategic partner, with an immediate transfer of management supervision, and then in a second stage, set at four years later, sell 17 per cent more of its capital and then a final 7 per cent two years after that.

The initial investment required from the prospective partner, as well as the many years before obtaining a majority share, put would-be investors off. So the government resumed negotiations and offered a quicker management transfer, sale of the 17 per cent in three years instead of four and reduction of the requirements for coverage and supply. The new plan was to be implemented by the second half of 2006 at the latest.

Ouagadougou airport is to be franchised and the one at Bobo Dioulasso to be under a leasing contract. Feasibility studies have been done and the process of inviting bids begun. Privatisation of the CBMP precious metals board, suspended in 2003, is back on the agenda. Other firms in the process of privatisation or being wound up include hotels, cinemas, transport and vehicle inspection. But privatisation, especially of Sonabel, Sonabhy and Onatel, may be delayed in 2005 as an election year is rarely the best time for such changes.

The crisis in Côte d'Ivoire has seriously affected transport, especially road traffic to Burkina Faso. Before the crisis, two-thirds of the country's goods exports and imports passed through the port of Abidjan. The region's businesses, Burkinabè or Malian, quickly adapted to the loss of access by switching to routes through Ghana, Benin and Togo, whose governments co-operated to dispatch goods through their ports more easily.

The crisis had the effect of reviving major regional projects to build or improve main roads through WAEMU countries, among them Burkina Faso's transport sector programme PST-II 2000-08. This includes the surfacing of the road from Ouagadougou to Léo and the Ghanaian border and improving roads from Ouagadougou to Pô (towards Ghana), Bitou (towards Togo) and Fada-N'Gourma (towards Niger). Funding agencies are already extensively involved.

The measures to cope with the Ivorian crisis helped contain the higher transport costs but road traffic through Burkina Faso has increased three or four-fold in the last two years, causing serious damage to the roads, especially from overloaded vehicles, 70-90 per cent of trucks exceeding the 11.5 tonne weight limit set by the Economic Community of West African States (ECOWAS). Funding sources are supporting the installation from late 2004 of checkpoints with weigh stations, as on the Bamako-Ouagadougou-Accra and Bamako-Ouagadougou-Niamey roads. But enforcing such rules at regional level is likely to be slow and difficult.

A mid-stage progress report on PST-II published in November 2004 was fairly positive, at least about implementation and funding of the road projects. The programme aims to keep in decent repair the existing 15 272 km (87 per cent unsurfaced) of good roads by 2008, tar 1 324 km and improve 12 000 km of rural tracks, out of the country's total network of 46 000 km. Technical and financial partners have paid little attention to the tourism and railway sections of the PST-II programme. Foreign-funded feasibility studies are being done for a new airport in Ouagadougou which should be ready in 2015.

The banking sector is fairly solid, though structurally over-exposed to the cotton sector. It has excessive short-term liquidity and bad loans are quite low – 4.6 per cent net (13.1 per cent gross) in September 2004, compared with 3.2 per cent at the end of 2003 (11.3 per cent gross). But the financial system's penetration is very small and bank credit to the economy is only 13 per cent of GDP, which makes funding small and medium-sized enterprises (SMEs) a big challenge.

Burkina Faso does not have its own official definition of a small and medium size enterprise (SME). For the tax authorities, an SME is an officially-registered firm with an annual turnover of 15-50 million CFA francs ($30 000 -$100 000). The commerce ministry defines an SME as one with 5-10 employees. No really up to date data exist on how many there are, even in the formal sector, but they provide very many jobs, especially if the informal sector is included, including the countless cotton and vegetable farms that sell their crops.

SMEs, whether formal or informal, have little access to traditional bank loans and applications by existing firms and especially those starting up are often rejected.

3. The propensity of banks to fund the services sector, notably expanding sectors such as health or new communications technology, is greater than for other sectors. Pre-funding of cotton activity is a special case because it is done through Sofitex and involves a thoroughly integrated sector, so is no problem as long as Sofitex is solvent.

When they are accepted,[3] interest rates are very high (10-18 per cent) and loans are basically for working capital and rarely long-term (only 1 per cent of all loans to the private sector).

Many obstacles hamper growth of bank loans to SMEs. Firms are quick to denounce the banks as unadventurous but the legal environment and the dearth of viable projects are also factors. Mortgages are the most popular security with banks but are sometimes hard to set up. Property rights were effectively abolished during the 1983-87 revolutionary government in favour of "urban residence permits" and many houses are still occupied under this arrangement. Property law is being normalised but this will take time and involves the costly introduction of land titles.

Local firms are rarely financially sound and transparent. Furthermore, some rules of the Organisation for the Harmonisation of Business Law in Africa (OHADA), such as extending from eight to 45 days the wait before a firm's assets can be seized in case of payment default, allowing it more time to put its affairs in order, may have increased the banks' reluctance to fund SMEs.

The government and funding sources have done much to encourage the financing of SMEs, including non-financial help such as advice on making a funding application with the help of the new one-stop business centre mentioned earlier, the establishment in 2005 of an experimental registered management centre (CGA) to help firms organise their accounting, and helping people financially to get business advice and training (the EU).

Funding structures (sometimes long-established) such as Papme (Association to Promote and Support SMEs) are among a multitude of facilities, often redundant and financially shaky, that seem to dominate the scene. Papme, which was set up in 1995 and now struggles along since its main funder, the EU, pulled out in 1999, duplicates the advice and support work done by bodies more recently set up. Burkina Faso appears to need a coherent policy towards SMEs, perhaps merging the various facilities into a specialised bank or guarantee fund to finance them.

The government has not yet produced a policy towards the very vigorous local micro-finance sector, which is still too fragmented and weak (except perhaps the main network, the Caisses populaires du Burkina Faso) to provide intermediate funding (5-50 million CFA francs – $10 000 - $100 000). After a national micro-credit conference in October 2003, the government was to unveil a national plan but it involves wide consultation with all parties in the sector and has been delayed and will not be ready until mid-2005.

Political and Social Context

The political situation in the run-up to the 2005 presidential election is fairly stable. The "national days of forgiveness" in March 2002 and changes to the electoral system in that year have helped ease tensions created by the 1998 murder of journalist Norbert Zongo and the energetic civil society protests set off by the killing seem to have died down.

The opposition, which benefited from the electoral changes at the May 2002 parliamentary elections, remains divided and its leaders, such as Hermann Yaméogo and Gilbert Ouédraogo, have not managed to bring together all its components and present themselves as credible alternatives to President Blaise Compaoré. Under these circumstances the ruling Congress for Democracy and Progress (CDP) party is well-placed before this year's vote.

Democracy is real in Burkina Faso, though political competition in the countryside is not as open as in urban areas. However, the CDP has yielded to the temptation to seek abolition of the ban on a third consecutive presidential term, laid down in the 1991 national constitution, and is campaigning for a third term for Compaoré, which the opposition and some civil society organisations oppose. A proposal to change the proportional voting system for local elections, to the predictable detriment of the opposition, is another backward step from the concessions made through the "days of forgiveness."

The government's legitimacy and Compaoré's popularity remain strong and the country is fairly calm (the return of Burkinabè fleeing the troubles in Côte d'Ivoire did not cause the disruption some feared), but there is growing discontent about corruption. The local anti-corruption NGO Ren-Lac says, in its annual survey of urban areas, that corruption is seen as growing in all sectors of society, especially health-care, along with customs, the police, education and public procurement.

The situation highlights the weakness of the legal system and the apparent lack of political will to halt corruption. The government anti-corruption co-ordination body HACLC (set up in April 2003) said in its first report in January 2004 that it had investigated 40 areas of government activity and found cases of embezzlement. It recommended measures to be taken to deal with such cases effectively. Prosecutions were begun shortly afterwards. Action in corruption cases highlighted by HACLC will be the responsibility of the legal system supported by the government, but nothing was done after previous government initiatives such as setting up a national ethics council and a council of "Wise Men", so observers are reserved about this latest move.

Burkina Faso is one of Africa's poorest countries and the UN Development Programme (UNDP)'s 2004 Human Development Report placed it 175th out of 177 countries listed. The ranking has raised questions, since countries at war for many years were placed higher, but life expectancy, literacy and school enrolment figures are certainly very low in Burkina Faso.

The country's anti-poverty policy is set out in a poverty reduction strategy paper (PRSP), of which a revised version was adopted in late 2004 for 2004-06 keeping the same priorities but focusing more on social sectors such as education and health that have been making little progress. Adoption of the new PRSP in autumn 2004 appears to have resulted from a thorough participatory and, for the first time, decentralised approach. Overall, national anti-poverty efforts have had mixed results in recent years.

A recent World Bank survey reported a drop in the poverty rate from 54.6 per cent in 1998 to 46.4 per cent in 2003 (though the 1998 figure, using a different methodology, was initially estimated at 45.3 per cent, which would mean poverty had actually increased). It compared poverty figures in the 2003 priority survey by the INSD national statistics and demography institute with the 1998 figures, adjusted to take account of a change of methods between the times of the two surveys. Poverty also fell more in the countryside than in urban areas, from 61.1 to 52.4 per cent.

The World Bank predicts that with steady annual economic growth of 5 per cent (a high estimate which does not allow for any external shocks), Burkina Faso could achieve the government's aim, included in the PRSP, of reducing poverty to 25-30 per cent of the population by 2015. The poverty rate, using the 2003 methodology, was nearly 60 per cent in 1994 (not 44.5 per cent as in an initial survey). This would mean that cutting poverty to 25-30 per cent would meet the target of reducing it by half between 1990 and 2015 and enable the country to fulfil the first of the UN Millennium Goals.[4]

Even so, social indicators record disappointing progress for a country with such steady economic growth (an annual average 5.8 per cent between 1994 and 2003) and with a government making an effort with solid support from funding agencies. But growth has brought little help to the poorest. The rural-urban divide is still deep and progress is very limited in education and health despite these areas' being PRSP priorities.

Much effort has been made to boost school enrolment and results are starting to show. Gross primary enrolment rose from 42 per cent in 2001/02 to 52.2 per cent in 2003/04, but this is one of lowest rates in the sub-region and the urban-rural enrolment disparity has worsened. The literacy rate, which increased from

4. In 1994, as in 2003, the level of income used to calculate the national poverty rate was roughly the same as the one dollar a day (at purchasing power parity) used in the Millennium Development Goals, making poverty reduction comparable under either system.

18.9 per cent in 1994 to 21.8 per cent in 2003, according to a demography and health survey (DHS) in 2003, was one of the lowest in Africa.

The education system remains of poor quality, while demand for education steadily rises and access is difficult, with 36 per cent of pupils not having access to appropriate facilities, such as proper classrooms. Teachers are in short supply, with one for every 51 pupils on average. The INSD's 2003 poverty survey said only 40 per cent of pupils completed primary school (60 per cent in towns and only 30 per cent in the countryside).

In a bid to reduce the large regional disparities as well as the urban-rural one, the government provides totally free education in 20 priority provinces, an initiative which boosted girls' enrolment by 130 000 in 2004. Funding agencies have set up a common fund to help the education sector. Despite these steps, the PRSP targets of 70 per cent gross enrolment and 40 per cent literacy by 2010, as well as the Millennium Goal of universal basic education by 2015, would seem hard to meet.

Progress in health care has been even more meagre. The DHS showed infant mortality had dropped significantly, from 203 per 1000 in 1998 to 184 in 2003, but this was mostly among children less than a year old, while the chances of a child dying between the ages of one and five were virtually unchanged. The reduction was probably mainly due to good progress in expanding vaccination coverage for children up to 11 months old, since causes of child mortality (such as dysentery, respiratory infections, malaria and malnutrition) have not been significantly reduced.

The situation is just one sign of the weakness of the health system, which lacks adequate infrastructure and trained staff and so provides poor and expensive care. Disturbingly, use of health centres dropped from 58 per cent of the population nationally to 49.4 per cent between 1998 and 2003. In rural areas the decline was steeper, from 71 to 58 per cent. The alternative in towns and cities is provided by private doctors and in the countryside by traditional healers, since regular treatment is usually too expensive for the very poor.

Burkina Faso officially has a "generalised" HIV/AIDS epidemic,[5] with a 5.3 per cent infection rate among adults at the end of 2003, according to latest UNAIDS estimates. The 2003 DHS showed an infection rate of 1.9 per cent, reflecting different methods used (different sections of the population targeted). UNAIDS said its figures suggest the epidemic is levelling off. If so, this would be the first results of a battle against the disease that has included co-operation with traditional healers, whose influence in communities makes them essential partners.

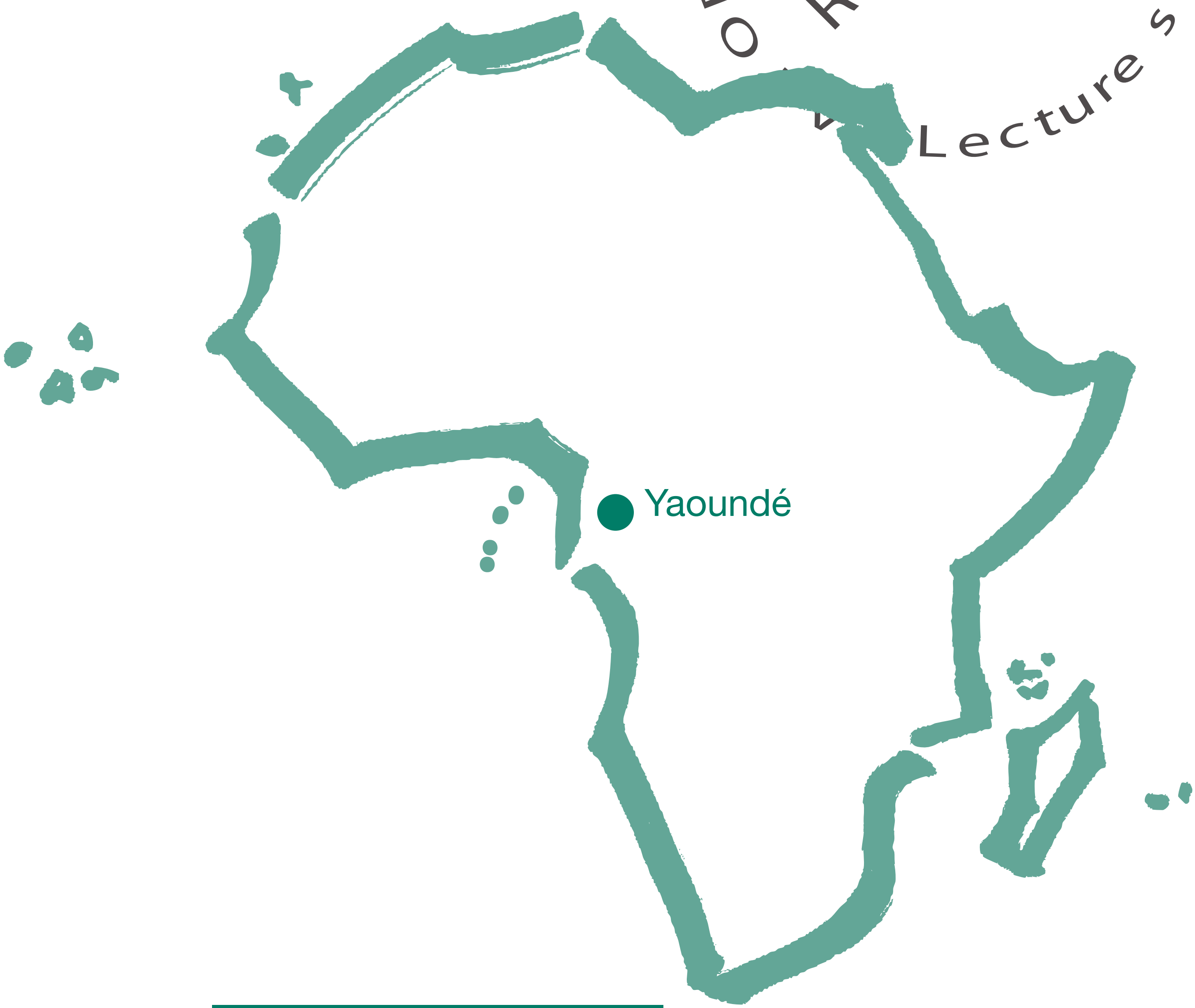
Nationwide poverty reduction requires narrowing regional disparities as well as urban-rural ones, especially in access to social services, and is one of the revised PRSP's priorities. More co-ordination between funding agencies and with the authorities, as well as harmonising and simplifying the procedures of the technical and financial partners, is also needed.

Progress is being made in this with the common funds for health and basic education set up by the funding agencies and bringing the World Bank and the African Development Bank (BAD) into the Joint Budget Support for PRSP (JBS-PRSP) group that had comprised only bilateral European partners and the EU.

At a local level, the challenge is to strengthen capacity and governance and decentralise implementation of the PRSP, promoting local ownership of it through regional versions. So the new focus on village development councils and interest in implementing and assessing the PNGT-II national land management scheme are very encouraging developments.

5. An epidemic becomes "generalised" when more than 1 per cent of the population is infected.

Cameroon



key figures

• Land area, thousands of km²	475
• Population, thousands (2004)	16 296
• GDP per capita, $ (2003)	862
• Life expectancy (2000-2005)	46.2
• Illiteracy rate (2004)	24.2

President Paul Biya was predictably re-elected in October 2004 after more than 20 years in power. Meanwhile the country failed to qualify for new international funding by missing the year-end target for reaching completion point under the Heavily Indebted Poor Countries (HIPC) initiative.

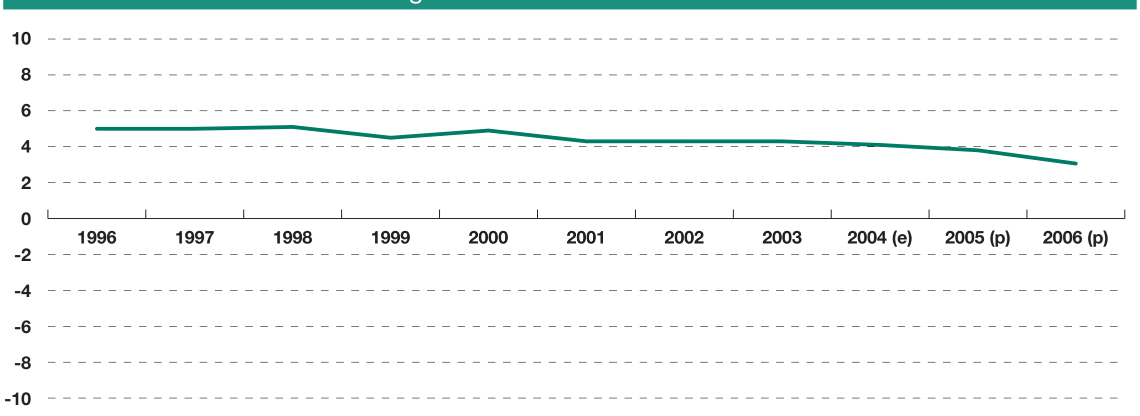
Economic conditions were good thanks to robust external demand and increased electricity supply, but domestic arrears (due to non-payment of subsidies, late payments to country-creditors and non-payment of suppliers) built up. This suggested major budgetary indiscipline through unbudgeted spending in the run-up to the elections. The International Monetary Fund (IMF) programme review was therefore not conclusive and the HIPC completion point was not reached. The loss of a year's HIPC benefits sanctioned the country's lax budget management and meant that cancellation of old and additional debts was postponed.

Growth has slowed since work finished in 2002 on the Doba-Kribi oil pipeline, which had boosted the construction sector and created thousands of jobs. The main reason is lack of infrastructure and high production factor cost. Oil and gas production fell in the absence of significant new discoveries but government revenue from the sector held up in 2004 due to higher oil prices, making up for lower revenue from other sectors. Providential income from hydrocarbons made up to some degree for poor tax returns from the non-oil sector .

The target date for the HIPC completion point has again been postponed despite impressive growth.

Structural reforms made good progress, but firms suffered from very poor business conditions. Transparency International regularly ranks Cameroon among the the world's most corrupt countries and businesses complain[1] of legal and judicial insecurity.

Figure 1 - **Real GDP Growth**

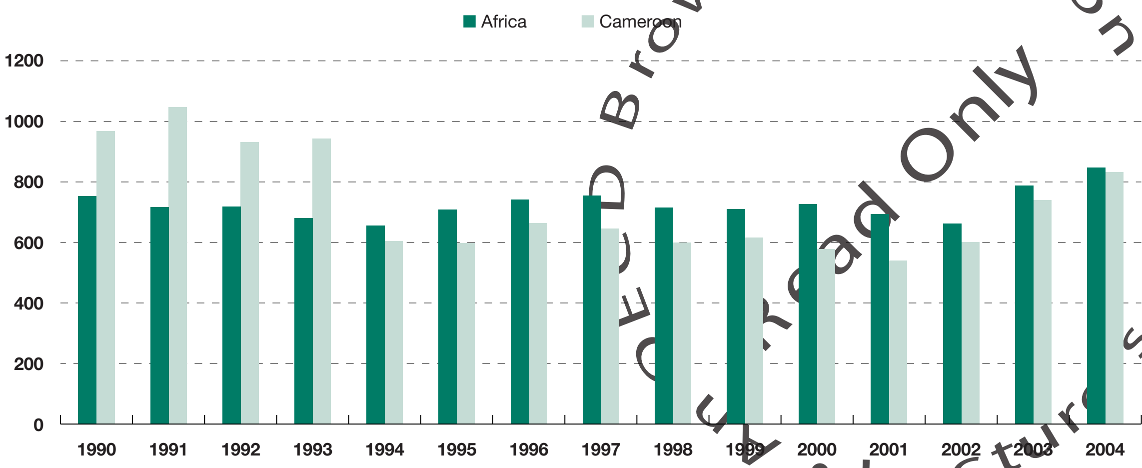


Source: Data from the Direction de la Prévision, Ministry of economy and finance, and authors' estimates (e) and projections (p).

Firms are also handicapped by energy shortages, lack of long-term funding and a poor physical infrastructure that complicates access to the country's economic capital, Douala. The private sector is increasingly plagued, too, by fraud and a massive influx of counterfeit products. National growth fell slightly in 2004 to

1. Local businesses, in a report by the Expanded Inter-Ministerial Committee for the Private Sector (April 2003), said legal insecurity was a bigger problem for them than funding.

Figure 2 - **GDP Per Capita in Cameroon and in Africa** (current $)



Source: IMF.

4.1 per cent and is expected to shrink further in 2005 (to 3.6 per cent) and 2006 (3.1 per cent) because of a steady fall in oil production.

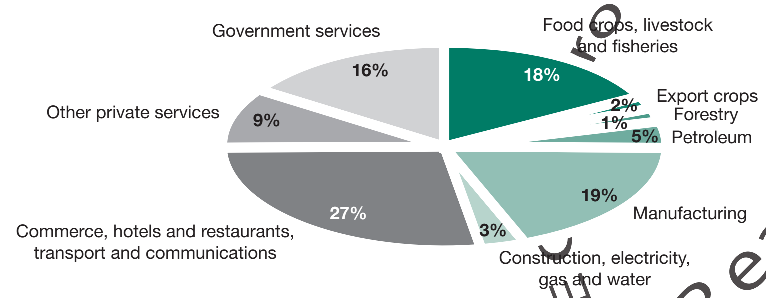
Recent Economic Developments

Despite a slowdown, the primary sector contributed to overall growth in 2004 thanks to good performance of food and export crops as well as the timber industry. The 2003/04 season showed increases for cocoa (6.8 per cent – 188 400 tonnes, up from 176 300 tonnes), cotton (3.8 per cent – 242 800 tonnes, up from 233 800) and coffee (3.2 per cent – 65 000 tonnes, up from 63 000). However, because of the European Union quota system banana exports are thought to have fallen by between 10 and 20 per cent in 2004. As a result producers did not fully benefit from higher prices on the international market and will have to take steps to cut production costs. Livestock production fell 5.4 per cent over the year, with egg producers having to close some farms and lay off 18.5 per cent of their full-time staff.

Production of bananas, which have a big local market, has been sluggish for several years, leading to increased prices in early 2004. A plan to boost output, Prebap, is to be launched in 2005, to double plantain production by 2009 (to 3 million tonnes from the present 1.5 million, of which barely 200 000 are exported). The plan is counting on strong growth in urban household consumption, which is currently only an annual 7 kg per person, compared with 176 kg in the countryside. The goal is also to streamline the distribution system, which at present often pushes up prices. The success of this initiative will require a change in the eating habits of Cameroonians, who consume much imported rice and wheat-flour. The Prebap programme could eventually create about 125 000 jobs in the countryside (6 000 people presently work in the sector) and lead to more industrial banana activity that would boost the economy.

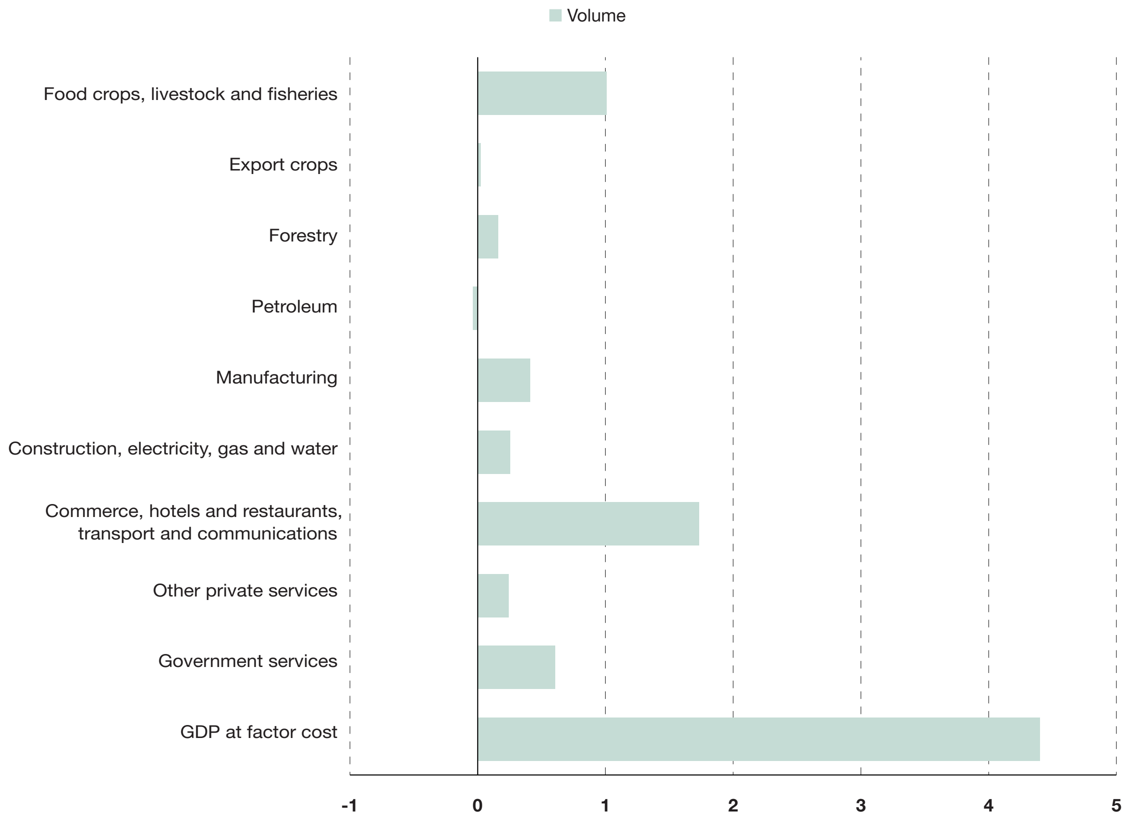
Introduction of a forestry code in 1994 and a partial ban on the export of logs in 1999 have led to rapid industrialisation of the timber sector, which is now the region's most developed. Sales of processed wood rose 6 per cent in 2004, from 644 900 to 683 600 tonnes. Log production increased even more, by 17.6 per cent (1.7 to 2 million cubic metres). But, like most businessmen, timber operators complain they cannot easily get loans from banks or suppliers, or collect debts owed them, factors that create serious cash flow problems that have caused layoffs, as in other sectors. The timber equipment usage rate, generally low in Cameroon because machinery is outdated, therefore is thought to have increased in 2004. Other problems, such as licence renewal and a dearth of new felling areas, could slow the industry's growth in the future.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on data from the *Direction de la prévision*, Ministry of Economy and Finance.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on data from the *Direction de la prévision*, Ministry of Economy and Finance.

Oil production continues to fall as a result of a continuing lack of new discoveries and declined 7.3 per cent (from 35.6 to 32.9 million barrels) in 2004, which adversely affected growth. But prospecting continues because of high world prices and the state oil company SNH says it plans to drill some 20 wells in 2005. Even so production is expected to fall a further 8.2 per cent in 2005.

As for the industrial sector, output slowed in 2004 because of reduced activity in textiles, chemicals and packaging. But a return to normal rainfall and more

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**14.0**	**16.9**	**15.6**	**15.9**	**15.3**	**17.3**	**17.9**
Public	2.3	2.2	2.3	2.3	2.1	2.8	3.2
Private	11.7	14.7	13.2	13.6	13.2	14.5	14.7
Consumption	**80.4**	**81.2**	**81.0**	**80.6**	**80.7**	**79.2**	**79.4**
Public	9.0	10.2	9.6	9.8	10.7	10.8	11.3
Private	71.4	71.0	71.4	70.8	70.1	68.4	68.1
External sector	**5.5**	**1.9**	**3.4**	**3.5**	**4.0**	**3.4**	**2.7**
Exports	23.7	22.8	22.8	23.1	23.8	23.6	23.0
Imports	-18.1	-20.8	-19.3	-19.6	-19.8	-20.2	-20.3

Source: Data from the *Direction de la prévision*, Ministry of Economy and Finance, and authors' estimates (e) and projections (p).

investment by the electricity company, AES-Sonel, helped boost power production in 2004, though supply was still erratic. Dams were still not full enough for maximum output, in spite of higher rainfall, and the opening of a new thermal plant at Limbé was delayed until the end of the year..

Cameroonian industry is fairly developed as a result of targetted government policies since the 1960s. After stagnating in the crisis years of the 1980s, when the informal sector developed, industry became more competitive after the 1994 devaluation of the CFA franc, but problems remain. Smuggling and fraud increasingly handicap industry. The weakness of the US dollar has also made local Cameroonian products less competitive over the past two years. Furthermore, the economy lacks major projects since completion of the Doba pipeline carrying oil from Chad to the Cameroonian port of Kribi. Nearly 2 000 local firms were involved in associated activity worth around 230 billion CFA francs ($434.5 million). Nearly all the project's workers (5 659 out of 6 420) were of Cameroonian origin. National production factor costs are quite high, but the national telecommunications network is to be upgraded soon with fibre-optic cable that runs through the pipeline.

The very buoyant services sector was the main source of growth in 2004, with healthy performances by transport, telecommunications and non-tradable services. Transport of goods and passengers rose sharply because of efforts by urban transport operators, who modernised their fleets and improved securityr with more safety checks. Freight traffic was steady at Douala autonomous port in the first nine months of 2004 year-on-year and rail passengers rose by 21 per cent over the same period while the transport of goods by rail declined by 2 per cent. The number of telecommunications subscribers increased further in 2004 mainly because of the booming mobile phone industry and its expanding network. Supermarket business was slower, probably because of falling household incomes in 2004.

Growth in 2004 was again based on higher domestic demand through increased consumption and, to a lesser extent, exports. But household consumption has begun to slow because of delayed payment of secured debts, which include salaries. Public investment has also declined since completion of the pipeline. Implementation of HIPC projects should accelerate in 2005 and boost incomes and household consumption in both urban and rural areas.

Macroeconomic Policies

Fiscal and Monetary Policy

As a member of the Central African Economic and Monetary Community (CEMAC), Cameroon has to comply with various convergence criteria concerning inflation, budget balance, debt ratios and absence of debt arrears. It met them all in 2003 and probably in 2004 as well.

Until the end of 2004, Cameroon had a poverty

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**13.2**	**18.1**	**18.3**	**17.1**	**16.6**	**16.7**	**17.0**
Tax revenue	11.2	15.9	16.1	14.6	14.6	14.6	14.6
Oil revenue	2.9	4.8	4.9	4.1	4.1	4.1	4.1
Total expenditure and net lending[a]	**13.4**	**16.8**	**16.1**	**15.3**	**15.7**	**15.6**	**16.7**
Current expenditure	12.4	13.5	13.5	13.2	13.8	13.0	13.8
Excluding interest	*7.7*	*10.3*	*10.9*	*10.9*	*11.9*	*12.1*	*12.5*
Wages and salaries	3.8	4.9	5.2	5.2	5.3	5.3	5.6
Interest	4.7	3.2	2.6	2.3	1.9	0.8	1.3
Capital expenditure	1.0	3.3	2.5	2.1	2.0	2.6	2.9
Primary balance	**4.5**	**4.4**	**4.8**	**4.0**	**2.7**	**1.9**	**1.6**
Overall balance	**-0.2**	**1.3**	**2.2**	**1.8**	**0.8**	**1.1**	**0.3**

a. Only major items are reported.
Source: Data from the *Direction de la prévision*, Ministry of Economy and Finance, and authors' estimates (e) and projections (p).

reduction and growth facility (PRGF), approved in October 2000 by the IMF and extended for a year after a delay in disbursement of the loan. However the fifth IMF review in May 2004 was not conclusive and IMF monitoring, without disbursements, may be imposed in early 2005. Completion point cannot be reached until a new PRGF-type programme has been approved and a full review of performance done.

Pressure on government finances grew in 2004 because of growing arrears in payments to state firms and bodies, which led in turn to lower tax revenues. There were also delays in repaying internal debts, half of which are bonds floated on the local market to pay off earlier arrears (to suppliers, banks and for wages). The government seems to have repaid only some, such as to the social security system, and the global ratings agency Fitch said the government built up arrears to bondholders during the year.

Fitch questioned Cameroon's creditworthiness in view of this worsening of budget management but, for lack of clear evidence of payment defaults, simply put it under negative watch in July 2004 while awaiting developments. Standard & Poor's downgraded its rating of the country at the end of 2004, from B (speculative) to CCC (high default risk) for long and short-term commitments, and said the government would not meet its non-oil revenue targets in 2004 because of poor income tax collection and economic stagnation. Major non-budgeted expenditure and the need to subsidise the bankrupt national airline Camair and the post office savings bank were other blows to public finances in 2004.

Despite the upturn in oil revenue because of higher oil prices in 2004, budget receipts were lower than expected due to a drop in non-oil revenue – to 954.9 billion CFA francs ($1.804 billion) from the budgeted 1 191 billion CFA francs ($2.25 billion). Oil revenue was 337.7 billion CFA francs ($638 million), up from the projected 256 billion CFA francs ($487.7 million), and came from SNH, which sells the oil the government gets in production-sharing agreements with foreign companies.

This share was 40 per cent in the early days of production but as proven reserves failed to expand, and in a bid to lure new investors, it declined in later contracts signed under the 1999 oil code. This shrinkage has led to extraction from marginal oilfields such as Ebome, offshore from Kribi. Cameroon has also been getting revenue since the end of 2003 from transit rights paid by users of the Chad-Kribi pipeline, as well as taxes and duties[2] paid by firms involved in building the pipeline and dividends as a shareholder in Cameroon

2. These are not counted as oil revenue.

Oil Transportation (Cotco), which is part of the Chad oil production consortium[3].

Expenditure was thus revised downwards, with capital spending cut by half, so the overall budget balance was better than planned. Expenditure for the main item, wages and salaries, rose 4.9 per cent compared with 2003. The overall surplus was only 0.8 per cent of GDP (down from 1.8 per cent in 2003) but should rise in 2005 to 1.1 per cent because of tighter budgetary discipline, before falling again in 2006 to 0.3 per cent as a result of a further drop in oil production.

New non-oil taxation is planned in 2005, including widening the tax base and updating some taxes and tax-scales to align them with CEMAC directives, especially excise duties on beverages and tobacco. Tax exemption for computer products will be abolished. The 2005 budget is balanced at 1 721 billion CFA francs ($3.4018 billion), 6.4 per cent up on 2004's 1 617 billion CFA francs ($3.055 billion). This is fairly optimistic in view of the decline in oil production in 2005. Half of all spending will go to recurrent items, about 20 per cent for investment and nearly 30 per cent for public debt repayments. The budget shows efforts to cut recurrent spending and the government wants to use this margin for maneouvre to reduce its domestic arrears and increase investment loans.

Only 50 billion CFA francs ($94.5 million) – about 30 per cent – of the 160 billion ($302.3 million) in the HIPC account at the central bank had been drawn for social sector spending by 31 May 2004. This may be an exaggeration because the government was 43.5 billion CFA francs ($82.2 million) behind in payments to the account on that date. Some 30 billion CFA francs ($51.7 million) for education and 24 billion ($41.4 million) for health were allocated in the 2003 budget, but little of the money was used – only 11 billion CFA francs ($19 million) for education and 4 billion ($6.9 million) for health.

The exchange rate in Cameroon, as in other CEMAC member-states, is pegged to the euro and monetary policy is in the hands of the Bank of Central African States (BEAC), leaving fiscal policy as the country's main economic instrument. Inflation was only 0.2 per cent in 2004, mainly because of lower food prices, despite more expensive plantain bananas. The prices of other items, especially beverages and tobacco, rose sharply because of higher duties on them, and transport costs went up because of higher oil prices. Inflation could reach 2.2 per cent in 2005 and 2.5 per cent in 2006 as a result of increased demand by neighbouring countries for Cameroonian food crops. New taxes on beverages, tobacco and other items may also significantly boost inflation.

External Position

Cameroon exports a wide range of products but dependence on oil is still very high (39.5 per cent of all export revenue in 2004, according to the BEAC). Wood is the next biggest item (14.5 per cent), followed by cocoa (8.8), cotton (5.1), aluminium (3.7) and coffee (2.8). Oil export revenue rose about 10 per cent in 2004, despite falling production, while exports as a whole only increased 8 per cent because of smaller sales of bananas, aluminium and cocoa. Imports were up about 4 per cent after dropping when work on the pipeline finished. Fuel imports rose 15 per cent and machinery and equipment by 10 per cent. The 2004 trade surplus should be 1.4 per cent of GDP and then gradually decline to 0.4 per cent in 2006 because of the drop in oil production.

Measured in real-exchange-rate terms Cameroonian exports have become steadily less competitive since the 1994 devaluation of the CFA franc. Competitive margins (advantage measured by the difference between the real effective exchange rate today and that just after the devaluation) were only 8.5 per cent in 2002 and 5.4 per cent in 2003, according to the 2004 economic and financial report in the 2005 budget. Local firms

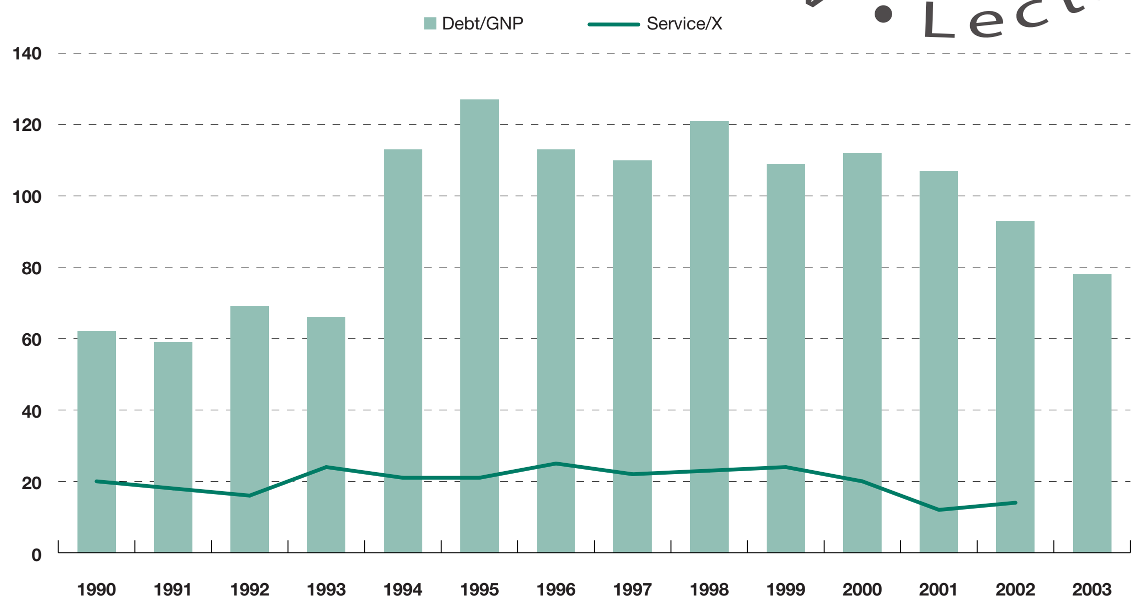
3. Chadian oil production should earn Cameroon $500 million (an average $20 million a year) over 25 years, a quarter of what Chad gets from it.

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Trade balance	6.9	0.9	0.6	1.3	1.4	1.1	0.4
Exports of goods (f.o.b.)	20.6	20.2	17.7	16.9	17.2	17.3	16.8
Imports of goods (f.o.b.)	-13.7	-19.3	-17.1	-15.6	-15.8	-16.2	-16.3
Services	2.4	-4.4	-5.9	-3.7			
Factor income	5.8	-3.1	-2.7	-2.6			
Current transfers	-1.2	1.6	1.4	1.7			
Current account balance	**14.0**	**-5.0**	**-6.6**	**-3.3**			

Source: BEAC data and authors' estimates (e) and projections (p).

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

were also hit by unfair competition from smuggled or counterfeit imports, especially clothing, sugar, cigarettes, batteries, flour and fuel. An investigation of 13 local firms by the main national employers' organisation, Gicam, estimated a loss of about 35 billion CFA francs ($66.1 million) worth of business and laid off 900 workers in 2003 because of these practices.

Cameroon's projected external debt in 2004 was $5.86 billion – 116 per cent of exports (in NPV), down from 166.8 per cent in 2003 and 170.5 per cent in 2002. So the country has shed considerable debt since the start of the HIPC Initiative, but despite structural reforms, it was unable to reach completion point at the end of 2004 as planned, which has delayed further debt cancellation and also France's C2D arrangement (debt relief and development contract). Debt servicing may therefore double in 2005, according to the Caisse autonome d'amortissement, the national sinking fund.

Structural Issues

Business conditions in Cameroon are very poor and include official corruption, an erratic legal system, a great deal of red tape, lack of appeal facilities and inadequate infrastructure. A technical audit of the legal system highlighted major failings and an action plan is to be launched soon. Reform of procurement procedures, begun in 2000, led in February 2001 to the creation of a regulatory body, the ARMP, with powers to investigate, monitor and expose irregularities, according to its director-general. The main innovations include the establishment of procurement commissions, monitoring committees, penalties, presence of independent observers in contracts bigger than 30 million CFA francs ($56 700) and independent auditing of results.

The World Bank database Doing Business says 12 steps are needed to start a business in Cameroon, slightly more than the African average of 11, but they only take 37 days, compared with 63 in the rest of the continent. It also notes that the labour market is much more rigid than the African average for hiring (61 on a scale of 100, against the average 53.2) and dismissal (80, compared with the average 50.6). Protection of investors is also very poor, with the country scoring very low (1 on a scale of 7) for transparency, though it is only 2.3 continent-wide. Most work needs to be done however on contract-compliance, where 58 steps are required for a complaint to be processed, over an average 585 days. These figures are much worse than the African average (35 steps over 434 days).

Cameroon has several definitions of SMEs (small and medium-sized enterprises) but the most common is by number of workers – more than 10 is an SME and more than 50 is a large firm. No data exist, however, so it is impossible to get a clear idea of the number of SMEs, their nature or the number of people they employ. Tax returns could give a rough idea but they aggregate all productive activity indiscriminately (such as that of licensed street-traders) and the data give no details of the firms except for their turnover, which is often under-reported. The Douala Chamber of Commerce keeps such a breakdown, but only of member firms. However, the secondary sector has about 270 large firms concentrated in the agro-industry timber, textiles, metallurgy, building materials and chemical products sectors.

The biggest brakes on SME growth in Cameroon are corruption, which represents a permanent burden and extra cost for firms and getting access to loans. The economy is much less competitive because of the loans problem, corruption, tax policies, red tape and poor basic infrastructure, according to a 2003-04 report on worldwide competitiveness.[4] Facilities giving SMEs extra loan security, such as the Fogape, have collapsed through bad management and banks are very wary of lending money to SMEs, complaining of shoddy applications and lack of serious guarantees. They provide no medium or long-term funding and the most they offer are overdrafts, so firms resort to quicker and easier traditional or informal loan sources such as tontines (joint savings arrangements), relatives or else moneylenders, who charge very high interest rates (4-5 per cent a month) and demand very rapid repayment.

This state of affairs was confirmed in a survey of 300 production sector SMEs by the Cretes economic consultancy that said they increasingly needed funds (3 per cent more in 2001 than in 2000), especially for investment, as working capital was easier to come by. They sought help first from credit institutions, then tontines, their suppliers or international bodies. But the average size of loans to SMEs dropped by 33 per cent between 2000 and 2002 and 54 per cent in 2001-02 while supplier credits steadily grew. More than a third (35 per cent) of SME funding needs were unmet in 2001 so supplier credit is the main source of help for these firms, which have no long-term funds for investment.

New funding sources for SMEs have begun to spring up however, such as the local Afriland First Bank and the private body PRO-PME (a Canadian project), which places emphasis on advising firms and boosting their capacity. A meeting organised by Gicam in November 2004, attended by about 60 firms and financial institutions, discussed guarantee funds such as those offered by Afriland, the African Development Bank's Proparco Fonds Gari and customer and supplier credit from City Bank. Technical and structural solutions

4. World Economic Forum.

were also discussed, including leasing, which make up for lack of guarantees. The country clearly lacks proper facilities to work with and help SMEs.

Cameroon's banking structure was completely reorganised after the crisis of the 1980s. Under the 1989-92 reform plan, five banks were dissolved, a debt-recovery firm (SRC) set up, the BICIC and SGBC banks restructured and financial aid offered to some other firms. Later reforms, after the 1994 devaluation, also changed the local banking scene, which now includes a dozen commercial banks, all members of the a national banking association, Apeccam, and all recognised by the Central African Banking Commission (Cobac).

The banks are still very choosy about which firms and individuals they lend money to because of the large reserves they have had to build up to cope with past bad debts and because they cannot rely on the law. However, some are trying to adapt their products to serve SMEs and help them fund growth. Nevertheless domestic loans rose 8.8 per cent year-on-year in second-quarter 2004, part of a 7.6 per cent rise in loans to the economy over the same period that was much higher than the credit control ceiling of 3.9 per cent. Meanwhile net government debt to banks fell. The country is thought to have about 650 microcredit organisations, with a total of 200 000 customers and accounting for less than 5 per cent of all deposits and loans.

Some privatisation remains to be done, but a new bid to sell the Cameroon Development Corporation (CDC) and the national plantations company (rubber, palm oil and bananas) was launched in May 2004 with a formal effort to recruit a consultant or a bank to take them in hand. The same thing was done with the telecommunications firm Camtel in February and the water company Snec in January. Sodecoton (cotton) should be next, with a call for bids. The government is expected to put together a new privatisation formula (probably on a contractual basis) for Snec, with the help of its development partners.

A temporary administrator was appointed for the national airline Camair in February 2005 to lead the move towards privatisation. The firm received government subsidies in 2004 but remained insolvent. A franchise to run the Douala container port was signed on 28 June 2004 with a Franco-Danish consortium, Maersk-Bolloré. Reorganisation of the port and clarification of the responsibilities of the customs service and private operators should help the new managers.

Political and Social Context

After 22 years in power, President Paul Biya, 71, was re-elected on 11 October 2004 for the fifth time, for another seven-year term, though it was only his second under a multi-party system. He won 75 per cent of the vote on a fairly high turnout (the government said 85 per cent) against 15 other candidates, though people seemed to show little interest in the election judging by the low voter registration (less than half the electorate, according to Biya). Transparent ballot boxes were used for the first time.

Cameroon is placed 129th out of 145 countries on the Transparency International's 2004 worldwide corruption index (it came 124th of out 133 in 2003), with a score of 2.1 out a possible 10 (no corruption), and is one of 60 countries where corruption is endemic. The new prime minister chairs the government's anti-corruption committee and has pledged to step up the fight so as to achieve the government's "great ambitions."

The oil-rich Bakassi region remains a bone of contention with neighbouring Nigeria, but significant progress was made in 2004 towards complying with the 10 October 2002 ruling by the International Court of Justice that it belongs to Cameroon. However, an agreement for a complete pullout of Nigerian troops by 15 September 2004 was not honoured.

In the health field, life expectancy is very low – only an estimated 45.1 years in 2004, well below Gabon's 57.4 and about the same as Chad (45.4), which is twice as poor as Cameroon. The HIV infection rate was 7.4 per cent at the end of 2003, sharply up from 2 per cent in 1990. HIV/AIDS has become a health ministry priority, as shown by a new demographic and health survey in 2004 into people's knowledge of the disease and the social stigma faced by sufferers. Anonymous voluntary tests were conducted to update statistics on the infection rate using a broader population sample than the internationally traditional one of pregnant urban women. First results suggest a fall in the infection rate. The price of anti-retroviral drugs is expected to fall sharply, from 13 000 CFA francs a month per patient to less than 5 000.

Widespread malnutrition, affecting 22.8 per cent of children under five, was also highlighted in the survey through voluntary tests for anaemia in men,women and children. Malaria eradication is a big part of Cameroon's health efforts and the ministry has launched an extensive publicity campaign targeting the two main risk groups, young children and pregnant women. It has bought 150 000 mosquito nets and 72 000 have been treated and distributed to pregnant women. Another 810 000 are being bought with HIPC funds. Tuberculosis, with some 18 000 new cases a year, half of them linked with HIV/AIDS, is also a problem. The national anti-TB programme has brought the price of drugs down from 48 000 CFA francs to 5 000 and treatment is sometimes provided free.

An expanded vaccination programme (EVP) has been strengthened and by December 2003 covered 72.5 per cent of the population for diphtheria, whooping cough and tetanus. It also includes injections against yellow fever, hepatitis, polio and measles. But despite these efforts, infant mortality (of children less than a year old) has only fallen very slightly, rising from 65 per 1 000 in 1990 to 77 in 1998, then dropping to 76 in 2000 and 74.6 in 2001. The number of women getting midwife-assisted birth rose from 63.8 per cent in 1990 to 75.7 per cent in 2000.

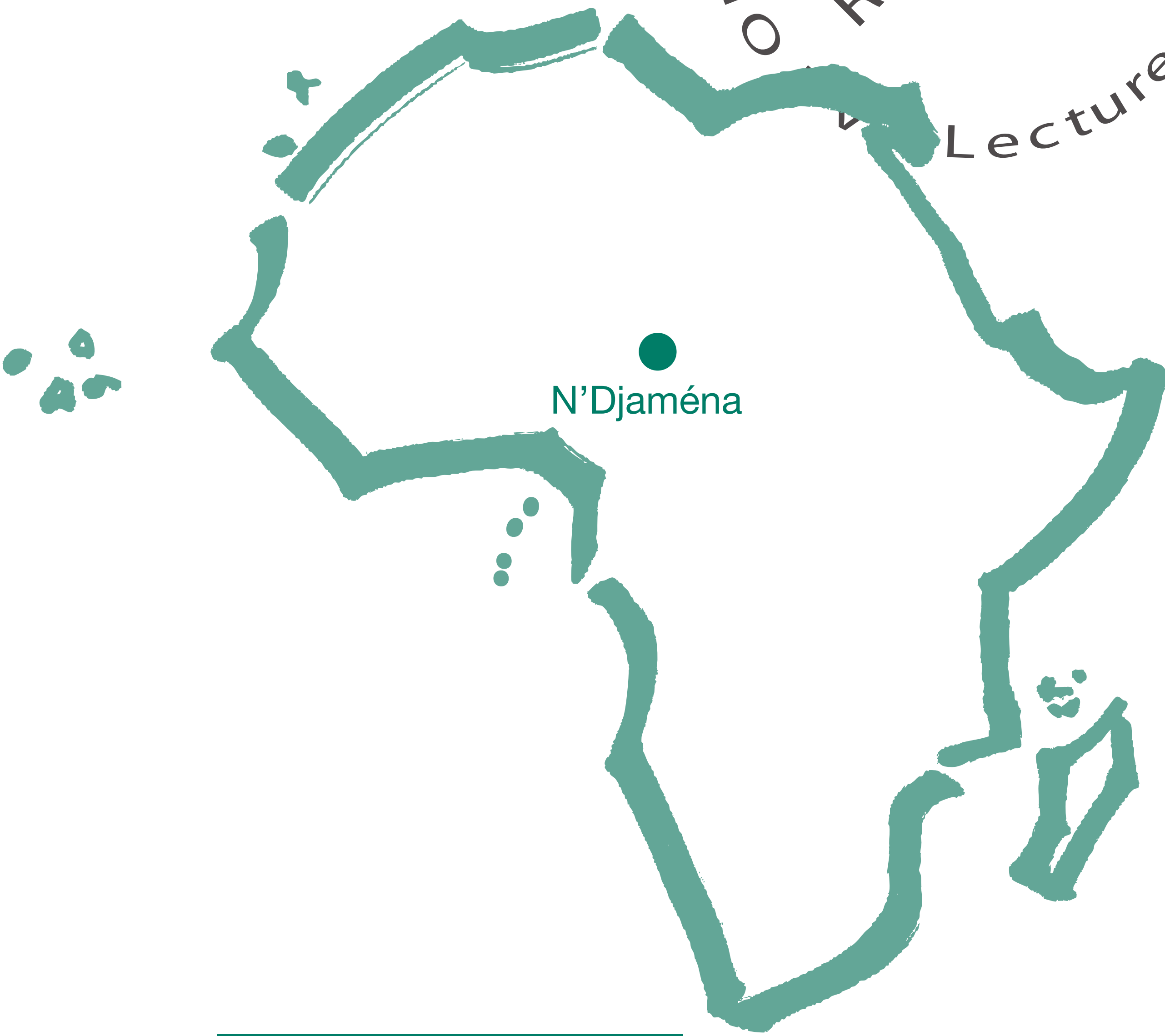
A cholera epidemic broke out in early 2004 along the coast and was still not under control at the end of the year. Despite health measures, 5 000 cases have been reported, mainly around Douala, from where the disease has spread to seven other centres. The outbreak is closely tied to stagnant water, bad housing and lack of sanitation. Only 7.3 per cent of households had access to proper sewerage facilities in 2001 and only 50.5 per cent to clean water. Water supply and waste disposal are major problems in Douala and Yaounde. Most waste bins are an average of just over 500 metres from homes in Yaounde, where only 13 per cent of households use city-provided septic tanks for sewage.

Cameroon's gross school enrolment was 99.6 per cent in 2002/03 and 96 per cent of children had access to primary school. However, 41.2 per cent of children dropped out of school in 2002 before completing five years of education. Some 2 800 classrooms were built in 2004 and 718 more are on the way, but the education sector remains in difficulty. The ministry has launched a major campaign to recruit supply teachers (hiring 4 836 in 2003) to meet educational demand but this has caused fears about job security among teachers as a whole, 62 per cent of whom work in state schools and 38 per cent in private ones.

Classroom overcrowding, the result of a shortage of teachers and poor infrastructure, has badly affected state education quality. The national repeat rate was 24.5 per cent in 2000/01 and only 57 per cent of children passed exams to enter secondary school in 1999/2000. The Nord province had pass rates in 2003/04 of only 10.29 per cent at age 14 and 32.9 per cent at the secondary school graduation examination (the baccalauréat).

Children switch increasingly to the better private school system as they get older. Most are still taught in state schools, but 36 per cent of secondary and 26 per cent of primary pupils are in private schools. A child living a poor suburb of Yaounde has to walk an average of 45 minutes to get to the nearest secondary school. In no part of the country do girls and boys enjoy parity of access to education.. The nationwide ratio improved in 2000/01 from 0.85 to 0.9, but boys were still 64 per cent of pupils in the Extrême Nord province and 63 per cent in the Nord province.

Chad



key figures

• Land area, thousands of km²	1 284
• Population, thousands (2004)	8 854
• GDP per capita, $ (2003)	307
• Life expectancy (2000-2005)	44.7
• Illiteracy rate (2004)	51.0

CHAD IS ONE OF AFRICA'S POOREST COUNTRIES, a landlocked state with the nearest access to the sea the Cameroonian port of Douala, 1 700 km from the capital, N'Djamena[1]. It has been torn by civil war for nearly 20 years and fighting still continues between ethnic groups and between cattle herders and crop farmers. The conflict in neighbouring Sudan also threatens Chad's security.

Good governance is vital in these circumstances, especially as the authorities must take account of the country's many languages[2] and the high rate of illiteracy (more than half the population). The economy is dominated by agriculture but the scale of livestock raising, the main export until the discovery of oil, is very hard to quantify because of the constant movement of herds and the porous frontiers. The informal sector is very large.

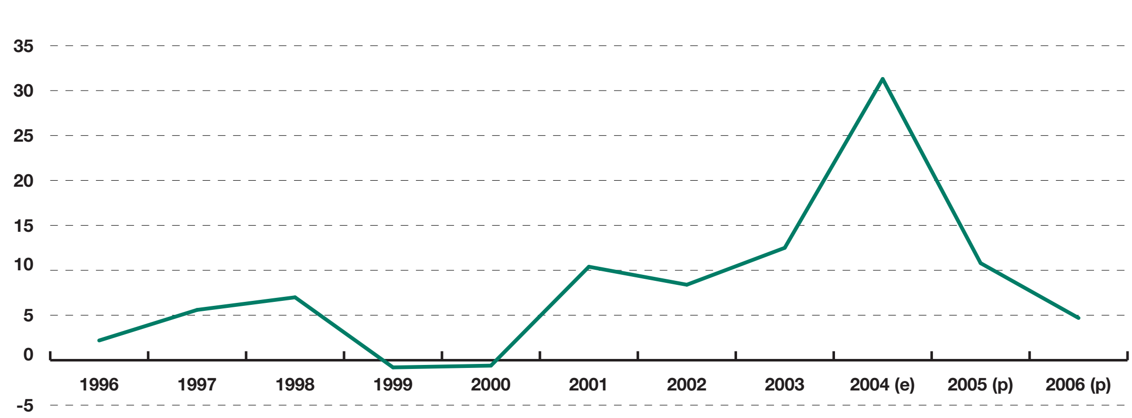
The economy took a decisive pace forward in 2004 when the first oil revenues made their appearance in the national budget after the mid-2003 start of production at the Doba oilfield. The government hopes for much from this new wealth, which has already begun to revolutionise the economy. The challenge is to use it to fight poverty effectively. A law on handling oil revenue was passed in 1999 in a bid to avoid the "Dutch syndrome" of countries which are heavily dependent on oil (falling non-oil exports, disruption of non-oil sectors, switch to a one-product economy and inflation).

The financial boost from oil production has been delayed.

Nevertheless Chad did not fully benefit from this new revenue in 2004 and public finances were severely stretched by non-disbursement of scheduled budget aid. Oil production has not yet reached its peak, but already the government has challenged the Doba consortium's sale price and is taking legal action over alleged lack of transparency over the quality discount and transport costs.

Growth averaged an annual 3.8 per cent between

Figure 1 - **Real GDP Growth**

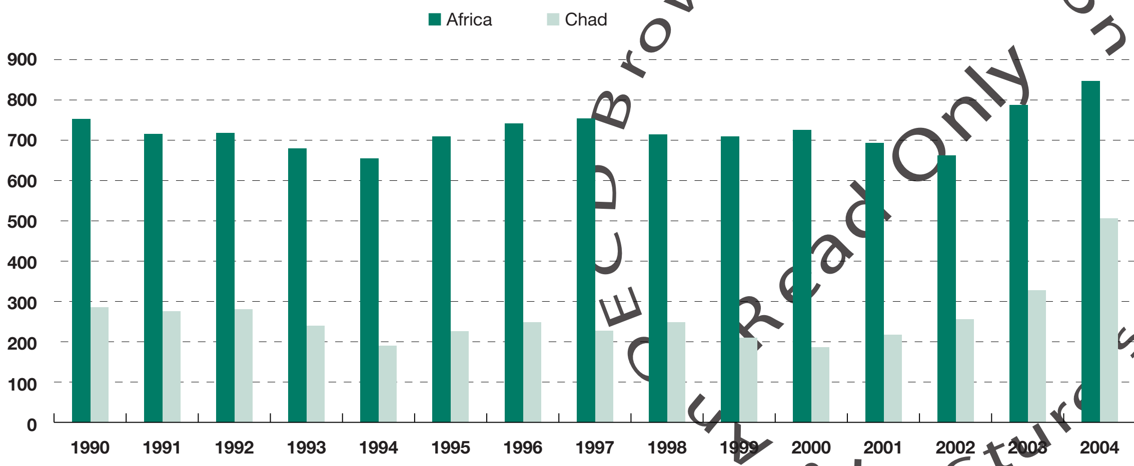


Source : Data from the national statistics institute Inseed and the IMF; estimates (e) and projections (p) based on authors' calculations.

1. The UNDP's worldwide *Human Development Report* 2004 gives Chad a Human Development Index score of 0.379, putting it in 167th place among 177 countries.

2. Chad is officially bilingual (French and Arabic), but 150 local dialects are also used.

Figure 2 - **GDP Per Capita in Chad and in Africa** (current $)



Source : IMF.

1986 and 1995 but has been very erratic since then, with two years of recession (1999 and 2000) and a spectacular leap forward from 2001 (when growth was 10.4 per cent), due to the building of the oil pipeline from Doba, in southern Chad, to the Cameroonian port of Kribi. Growth in 2004 was estimated at 31.3 per cent because of the start of oil production. Non-oil GDP rose 1.9 per cent, still below the estimated 2.6 per cent population growth. Growth should be 10.8 per cent in 2005, when oil output hits its stride, and then fall back to 4.7 per cent in 2006.

Recent Economic Developments

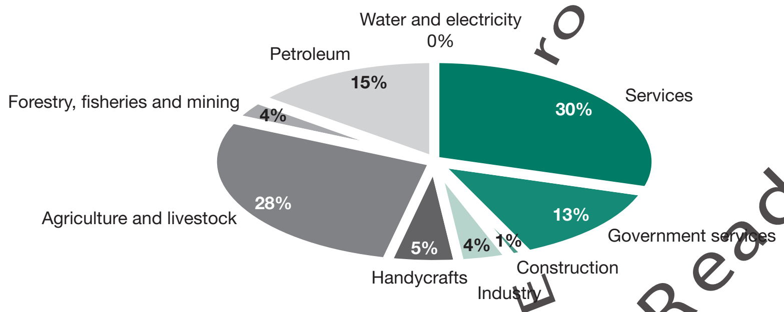
The primary sector accounts for 47 per cent of GDP, with oil representing 15 per cent in 2003 and rising. The oil extraction around Doba, which is 1 070 km from the nearest shipping point, required the building of an expensive pipeline to the port of Kribi and will also entail the drilling of 300 production wells and 25 others to inject water into the Doba Basin's three fields (Komé, Bolobo and Miandoum), at a total cost of $3.7 billion, mostly provided by a consortium of foreign oil companies and the World Bank. Proven reserves are almost 1 billion barrels, which will bring the government about $2 billion over the 25-year production period ($80 million a year).

Oil is a godsend for the economy, but presents problems. A $2-$4 per barrel quality discount had been planned but the Doba crude turned out to be more acid than expected and its high viscosity means it has to be heated to get it through the pipeline. This has pushed the quality discount up to more than $10. When prices are high, better quality will be required, which puts oil such as that from Doha at a disadvantage because it needs extra processing.

Another problem lies in the report that the consortium is selling its production to subsidiaries which could explain its lower value. Since the French firm Elf left the consortium (officially because of a policy change at headquarters), the US firms Exxon and ChevronTexaco and the Malaysian firm Petronas have been extracting oil under a 1988 agreement with the government. Oil revenue has been reaching the public coffers in stages. Production began in 2003 with 12.3 million barrels and reached 26.6 million in the first half of 2004. It should be 62.97 million for the whole of 2004 and belatedly reach full production in 2005, at 225 000 barrels a day (about 82 million a year).

The crisis in the cotton sector, which provided a third of export revenues before the arrival of oil, began several years ago when world prices fell and management problems developed in Coton Chad, which has a sector monopoly. The growing area had already shrunk by a

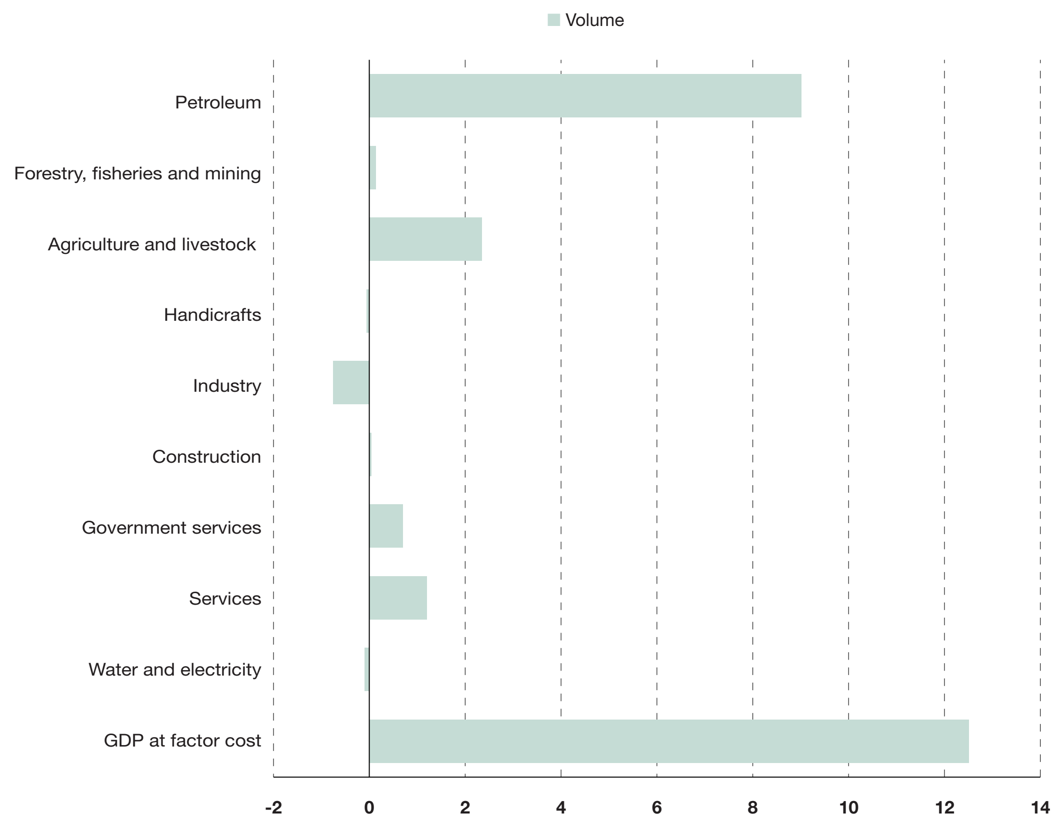
Figure 3 - – GDP by Sector in 2003 (percentage)



Note: The oil sector comprises extraction itself and other oil activity; traded services include commerce, transport and others, such as hotels and restaurants.

Source: Authors' estimates based on Inseed data.

Figure 4 - Sectoral Contribution to GDP Growth in 2003 (percentage)



Source: Authors' estimates based on budget data.

third between 1970 and 1988, from 300 000 to 200 000 hectares. After a poor harvest in 2003 due to the smaller area sown, the 2004/05 one should be better. Good weather and much higher prices to the farmer at the start of the season should push output of cottonseed from 126 800 to 180 000 tonnes (195 000 according to the agricultural statistics office), a jump of more than 40 per cent after a 19 per cent drop in 2003/04.

However, the April 2004 countercyclical increase in prices paid to farmers[3], from 160 CFA francs ($0.3) to 190 ($0.35) a kilo at a time when world prices were falling after two better years, is unlikely to remedy the crisis in the long term. The government may not be able to subsidise production every year and anyway that would not necessarily make Coton Chad more profitable.

Since the cotton crisis and before oil production started, livestock had become the main export in a country that had 16.7 million animals in 2004, according to the Bank of Central African States (BEAC). But these figures are not very reliable in the absence of recent surveys. It is very hard to give precise figures for nomadic livestock, in northern Chad. The government gets virtually no taxes from the sector, most of whose profits come from the export of cattle on the hoof and, to a lesser extent, of fresh meat (Chad has three slaughterhouses, but one is not operating). Cattle are sold mainly to Nigeria but it is hard to put a figure on the number, despite better staffing of borders and checkpoints. Live exports were put at 314 800 animals in 2004, up from 307 100 in 2003.

Cereals (mainly sorghum, maize and rice) are the household food staple of Chadians and after a very good 2003/04 harvest (up 33.4 per cent, at 1 612 500 tonnes), the results for 2004/05 are expected to be lower, at 1 226 900 tonnes (1 038 500, according to official figures). This 20 per cent drop is due to lack of rain, since desert locust damage was not great, according the UN Food and Agriculture Organisation (FAO). Other food production (manioc, sweet potato, groundnuts, sesame, fruit and other vegetables), mostly grown for home consumption, fell 15 per cent in 2004 to 1 061 million tonnes (1 250 million in 2003).

The secondary sector held back growth in 2003, mainly because of a shortage of energy supplies. Chad is the world's second biggest producer of gum Arabic (after Sudan) for which international demand has grown 40 per cent over a decade, with Chad's share rising from 10 to 25 per cent. The sub-sector has fewer than a dozen exporting firms providing 200 000 direct and indirect jobs, with collection still done manually. Exports increased to 17 100 tonnes in 2004 (16 000 in 2003) but local production remained steady at 12 000 in 2003 and 2004, suggesting that some of the exports were not of Chadian origin.

Sugar production has risen after major productivity investment by the state sugar firm CST, which in June 2004 forecast its output for the year at 33 800 tonnes, up 6.4 per cent from 31 700 in 2003, which was a stagnant year. Progress in the sugar industry is handicapped by extensive fraud from competing suppliers in neighbouring Cameroon and especially Nigeria.

Beer sales by the Logone Breweries (BDL) continued to fall, by 12.6 per cent from 111 388 hectolitres (2003) to 97 324 (2004), after two boom years in 2001 and 2002 reflecting construction work on the pipeline. Soft-drink output also fell, by 2 per cent, according to the national beverage company BGT, from 90 354 hectolitres (2003) to 88 280 (2004). But cigarette production rose a hefty 32.1 per cent (compared with only 2 per cent in 2003), with the national firm MCT turning out 48.3 million packets (36.6 million in 2003) due to increased demand.

Secondary sector activity shrank nearly 12 per cent in 2004, as a result of the end of oil prospecting (which peaked between 2000 and 2002) and the cotton crisis, which slowed down ginning. Construction again boomed (up 25 per cent) after expanding only 4 per cent in 2003. Electricity production still failed to keep pace with demand but increased 10.8 per cent, after falling 13.4 per cent in 2003.

The services sector remained very buoyant, growing more than 8 per cent (3 per cent in 2003) largely due to expanding commerce and public sector jobs. Transport and telecommunications grew by 7.6 per cent because of investment to enlarge the mobile phone network in the provinces.

Factors boosting demand in 2004 included completion of the Bisney-Ngoura-Bokoro road, the

3. In 2004, this price was close to those of the main cotton-producing countries in Africa's Franc Zone.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**17.4**	**39.0**	**57.4**	**44.1**	**22.9**	**15.6**	**15.1**
Public	6.1	5.5	8.5	7.9	6.7	6.2	6.2
Private	11.2	33.5	48.9	36.2	16.2	9.5	8.9
Consumption	**101.4**	**92.7**	**90.0**	**79.1**	**60.7**	**56.4**	**60.4**
Public	39.8	37.4	39.8	32.9	27.5	24.6	29.0
Private	61.7	55.4	50.2	46.2	33.2	31.8	31.5
External sector	**-18.8**	**-31.7**	**-47.5**	**-23.2**	**16.3**	**28.0**	**24.5**
Exports	18.5	19.3	17.5	25.7	55.0	62.2	56.3
Imports	-37.3	-51.0	-64.9	-48.9	-38.7	-34.2	-31.8

Source: Inseed and IMF data; estimates (e) and projections (p) based on authors' calculations.

start of road improvements elsewhere in the country, the beginning of crude oil sales and recruitment in key areas of government services. Non-oil activity slowed however due to the fall in investment in the oil sector, layoffs throughout 2003 by the contractors working with the oil consortium and lower agricultural revenue, the result of less cottonseed being bought and smaller output of food crops.

Macroeconomic Policies

Fiscal and Monetary Policy

As a member of the Central African Economic and Monetary Community (CEMAC), Chad has to comply with various convergence criteria concerning inflation, budget balance, debt ratios and absence of debt arrears. It appears to have met them all in 2004, notably in respect of arrears, unlike in 2003.

The Chadian government collects few taxes (the 2004 non-oil tax burden was 9 per cent), but oil revenue is rising (though it will only be 4.2 per cent of GDP in 2006). The economy is highly dependent on foreign aid, which in 2003 equalled tax and oil revenue combined. Oil revenue will increase budget revenue (excluding grants) by half in 2005 and 41 per cent in 2006.

Revenue was very high in 2003, the year before oil income began, thanks to the pipeline project, which paid substantial taxes during construction. However tax-breaks (notably on imports) for the consortium and its sub-contractors cost the government several tens of billions of CFA francs. The share of taxes in GDP has

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**13.4**	**12.9**	**14.9**	**16.6**	**14.8**	**14.6**	**15.8**
Tax revenue	6.5	6.3	7.1	7.6	9.0	9.5	10.4
Oil revenue	0.1	0.1	0.1	0.5	2.4	3.3	4.2
Total expenditure and net lending[a]	**17.6**	**17.7**	**20.1**	**22.2**	**18.9**	**17.2**	**18.3**
Current expenditure	8.5	8.8	9.9	9.4	8.0	7.2	8.2
Excluding interest	*8.4*	*8.1*	*9.1*	*8.8*	*7.4*	*6.6*	*7.8*
Wages and salaries	3.7	3.6	3.5	3.6	2.9	2.8	2.8
Interest	0.2	0.7	0.9	0.6	0.6	0.6	0.4
Capital expenditure	9.1	8.9	10.1	12.8	10.9	10.0	10.0
Primary balance	**-4.0**	**-4.1**	**-4.3**	**-5.0**	**-3.5**	**-2.0**	**-2.0**
Overall balance	**-4.2**	**-4.8**	**-5.2**	**-5.6**	**-4.1**	**-2.6**	**-2.4**

a. Only major items are reported.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

risen steadily, reaching 7.6 per cent in 2003, though this is still too low for the country's needs. But with the help of oil, the figure could top 15 per cent in 2006.

By 30 September 2004, the tax authorities had collected 53.5 billion CFA francs ($101.1 million) for the year, 75.1 per cent of the budgeted amount, while customs duties totalled 25 billion (70.5 per cent). Customs have little room for improvement because they have little capacity to modernise and national frontiers are very porous, a problem aggravated by the security situation. The best performing tax sector was pay-as-you-earn income tax which brought in 20.7 billion CFA francs ($39.1 million), more than company tax (15.9 billion CFA francs , $30 million).

Oil extraction began at the end of 2003, but the first oil revenue did not reach the national budget until July 2004. This delay was due to technical problems over signing an accounting agreement relative to the offshore account (where sales proceeds go) and the national accounts held at the BEAC. After a second tax payment in November 2004 that brought total oil revenue to 37.4 billion CFA francs, payments speeded up at the end of the year.

The provisional total of 2004 oil taxes (for February 2004 to January 2005) was 69 billion CFA francs ($130 million) against a revised projection of 81.4 billion ($70.6 million) – an 85 per cent collection rate. The oil revenue monitoring authority said 26.6 billion CFA francs ($50.2 million) had been allotted in December 2004 to nine priority sectors, a 72.4 per cent execution rate. Most of the projects were for public works, education and health.

Because it has no agreement with the International Monetary Fund (IMF), Chad has received much less loan income than expected – 57.7 billion CFA francs ($109 million), down from 81.1 billion ($139.9 million) in 2003. The tax authorities had failed to collect more than 7 billion CFA francs ($13.2 million) in taxes due by the end of September 2004, including about 1.2 billion ($2.3 million) from Coton Chad and 1.7 billion ($3.2 million) from the water and electricity company STEE, the two biggest state-run firms.

This revenue shortfall – lack of budget aid and poor performance of tax bodies – caused serious budget problems in 2004, including a build-up of 26.2 billion CFA francs ($49.5 million) in domestic arrears, 2 billion ($3.8 million) in external arrears and continued late payment of public sector salaries that began in last-quarter 2003.

The theoretical price[4] paid to cotton farmers in 2004 was 150 CFA francs ($0.28) a kilo, but the government pledged to pay 190 ($0.35) to get farmers to grow more. For a harvest estimated at 250 000 tonnes, the state subsidy would thus come to 10 billion CFA francs ($19.8 million) but only half that has been earmarked. The gap will add pressure on the budget again in 2005. The government's 2004 funding needs of 144.9 billion CFA francs ($273.8 million) should be largely met by external agencies, notably as grants. The overall budget deficit is slowly falling and was 4.1 per cent of GDP in 2004 and is estimated at 2.6 per cent in 2005, when oil extraction will be in full swing.

The 2005 budget includes 161.9 billion CFA francs ($320 million) for investment of oil revenue (2005 amounts plus rolled-over sums). After debt repayments and a payment to the Future Generations Fund (set up under the 1999 oil revenue management law), most of the money will go first to the public works ministry, then to the ministries of education and mines and energy. A quarter of interim Heavily Indebted Poor Countries (HIPC) initiative aid of 20.6 billion CFA francs ($40.7 million) will be spent on public works and the rest on health and infrastructure.

The exchange rate in Chad, as in other CEMAC member-states, is pegged to the euro and monetary policy is in the hands of the Bank of Central African States (BEAC), leaving fiscal policy as the country's

4. The price paid to farmers is calculated each year from 16 monthly indices covering two years (thus two harvests) on the Liverpool cotton market, with 5 CFA francs added for processing the seed.

Good Use of Oil Revenue Despite Smaller Amount than Expected in 2004

The 1999 law (n° 001/PR/99 of 11 January) governing use of oil revenue only concerns direct income from it in the form of taxes and dividends. Under a 1988 agreement between the government and the oil consortium, Chad gets 12.5 per cent of the wellhead value of total production, before quality discount and the cost of sending it through the pipeline to the Kribi terminal. Of the money received 10 per cent goes to the Future Generations Fund and the rest to priority sectors – 80 per cent to development projects after debt repayments, 15 per cent to the national budget and 5 per cent to the oil-producing region to compensate the local population.

A key part of the law is creation of an oil revenue monitoring authority that ensures transparent handling of the spending on priority sectors. The body ensures openness on the expenditure side, spending commitments and the use of disbursements. This seems to be working well, as at the end of November 2004, more than 70 per cent of direct oil revenue had been spent, mostly on the transport sector.

Nonetheless direct tax revenue has been much less than expected. Out of every 100 CFA francs of oil sold, fewer than 12.5 go to Chad because the quality discount and transport costs have to be deducted. Transport costs are set by the Chadian and Cameroonian firms in the consortium, the Chad Oil Transportation Company (Totco) and the Cameroon Oil Transportation Company (Cotco), and the quality discount started off at between $2.50 and $4.20 a barrel. In fact the price of Doba crude includes a discount of $10.12 a barrel in relation to the Brent crude benchmark price, a unit transport cost (according to volume transported and fixed costs) as high as $10.52 some months of 2004, and an average $25 base price proposed by the consortium, when Brent crude was around $40 on the world market.

By 30 September 2004, about 50 million barrels had been sold, earning the state $70 million in tax revenue. By comparison, Gabon will earn, for 99.6 million barrels production in 2004 (and taking into account the quality discount), nearly 640 billion CFA francs ($1 209.1 million) in taxes, almost ten times more per barrel than Chad.

main economic instrument.

Inflation in Chad is closely tied to agricultural production, which in turn is very dependent on the weather. High inflation was expected in 2003 because of the economy's transition to oil and because of past bad cereal harvests. But a good 2003/04 harvest was declared likely in mid-2003 as a result of adequate rainfall and inflation was minus 1.8 per cent year-on-year in 2003.

But inflation developed in the oil region in the south and in the housing sector in N'Djamena because of heavy demand by oil industry staff. The price of petrol at the pump twice rose slightly in 2004 because of the increase in the Brent price. The cost of building materials went up by 2.9 per cent and rents by 16.7 per cent between September 2003 and September 2004. Food crop prices (legumes, tubers and fruit) fell 4.4 per cent in September 2004 year-on-year but the cost of cereals rose 9.9 per cent.

The weak US dollar meant imports (much of Chad's consumer goods are imported) were 7.7 per cent cheaper and the annual general price index down by 3.6 per cent, both year-on-year in September 2004. Over the whole year, inflation should be minus 4.8 per cent. But prices are expected to rise again with the influx of oil revenue and a fall in agriculture production (especially cereals) in the 2004/05 harvest – by 4.5 per cent in 2005 and

2.7 per cent in 2006.

External Position

Chad's structurally negative trade balance was positive in 2004 for the first time thanks to oil earnings. Total exports by value quadrupled while imports fell 20 per cent (as in 2003) with completion of the Doba oilfield work. The trade balance went from an 800 billion CFA francs ($1 379.7 million) deficit to a surplus of 260.4 billion ($492 million). Oil became the chief export, bringing in 90 per cent of export earnings, rising from 8.6 million barrels in 2003 to 61.3 million in 2004, boosting sales from 130 billion CFA francs ($224.2 million) to 1 008.8 billion ($1 905.9 million).

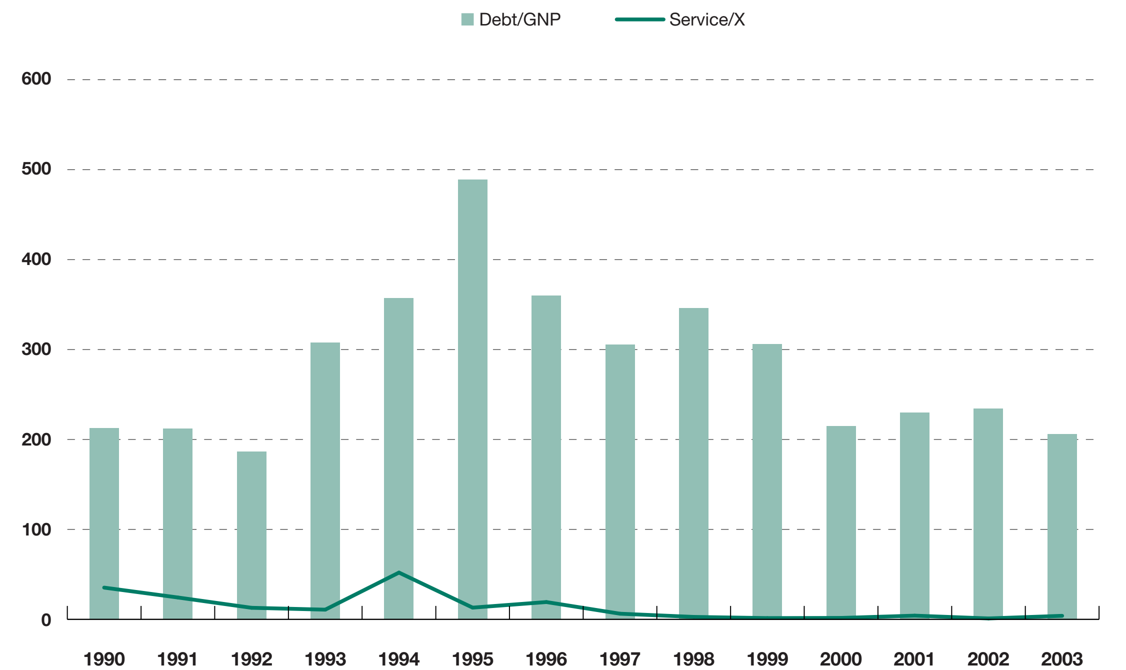
Volume exports of livestock rose by10.4 per cent and of gum Arabic by 6.7 per cent in 2004, but cotton fibre exports fell 20 per cent from 58 000 to 46 000 tonnes and the national statistics institute, Inseed, said sales were down to 40.02 billion CFA francs ($75.6 million) from 44.65 billion in 2003 ($77 million), 10 per cent of it due to lower world prices. The services balance suffered from the end of

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-0.3	-19.4	-32.2	-15.9	21.0	31.4	28.2
Exports of goods (f.o.b.)	14.8	11.1	8.6	17.6	48.7	56.6	51.3
Imports of goods (f.o.b.)	-15.1	-30.5	-40.8	-33.5	-27.7	-25.2	-23.0
Services	-11.2	-16.4	-20.5	-17.6			
Factor income	-0.6	-1.4	-1.5	-10.2			
Current transfers	3.8	2.7	1.9	3.2			
Current account balance	**-8.3**	**-34.5**	**-52.3**	**-40.4**			

Source: Inseed and IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

haulage activity linked to the pipeline construction.

Chad's total debt, 88.9 per cent of it multilateral, stood at 772 billion CFA francs ($1 458.5 million) at the end of September 2004. The country achieved decision point under the HIPC initiative in May 2001 and a month later obtained rescheduling of its public external debt from the Paris Club of nations. Under the enhanced HIPC initiative, this interim arrangement was converted into immediate cancellation by Club members of about $10 million of Chad's external debt, which reduced the cost of bilateral debt servicing from $17 million on 1 May 2001 to $2.4 million on 31 March 2003.

Structural Issues

Lawlessness and bad governance are hard to measure but they make it difficult to do business and discourage personal initiative. Questions about the safety of property and people will remain as long as the legal system lacks professionalism and material resources. But some legal and procedural improvements have been made, such as approving a sub-regional investment code, setting up commercial courts and standardising business law as part of Chad's membership of the Organisation for the Harmonization of Business Law in Africa (OHADA). The trade ministry, responsible for promoting the private sector, takes a regional approach as a way of getting round local constraints.

The private sector is sluggish and the economic weight of SMEs and SMIs (small and medium-sized enterprises and industries) is hard to assess for lack of data. Chad defines an SME as any firm with majority Chadian ownership and capital of less than 100 million CFA francs ($188 900). Anything bigger becomes one of the country's 30 or so large firms.

Red tape for starting a business is considerable and the World Bank database Doing Business says its takes 19 steps over 75 days to do so, compared with an African average of 11 in 63 days. The ministry in charge of SME/SMIs says most of such firms are in agro-industry. In 2004, 89 new firms were set up (and 65 renewed their registration), against 227 in 2003, when it was not yet obligatory to renew registration. Since there is no monitoring of firms, these figures are rough ones based on declarations of intent.

Growth of SMEs is obstructed by the landlocked nature of the country and by very high production factor costs. Electricity costs more than in most places

New Links Between Oil and the Private Sector

Chad signed an agreement with the International Finance Corporation (IFC) in December 2004 to help local firms take advantage of business opportunities in the oil sector.

It includes setting up, with the national chamber of commerce, a business development centre to strengthen local entrepreneurial skills and helping to improve SME access to funding. Very small firms (with two to five employees) will be able to get funding from micro-credit institutions such as Finadev (the country's main one), in which the IFC and Financial Bank have shares (IFC 25 per cent). The IFC opened up a guarantee line with two local banks in 2003 of €1 million for each, for maximum loans of €400 000 per firm. Technical experts will be provided to help run Finadev and manage the credit lines. A review is currently under way because one of the banks has not used the funding for lack of suitable loan applications.

The project will also put local firms into contact with the oil sector, an experiment to reduce costly imports, including food, largely from Cameroon, that currently meets the needs of most oil workers and is available locally. The goal is to identify markets and adapt local firms to the demanding time and quality requirements of the oil companies.

in Africa – an average 197 CFA francs ($0.37) a KWh before tax – and real estate is extremely expensive. Putting up a building can account for as much as 70 per cent of a firm's costs. Most businesses are run by individuals who nearly all start off with their own funds. Subsequently, the financial system provides few loans (for example, for harvests, storage or operating costs) or investment funding (for farm machinery, suitable transport, food-processing equipment or small-scale manufacture). Micro-credit, which is not very common, would help meet some of these needs.

The cotton sector, once the engine of national growth, has been in crisis for several years for a variety of reasons. The price of cotton in Chad, already one of the lowest in the world, has been hit by poor international prices and the weakness of the US dollar and has thus become less and less profitable for growers.

The industry processing firm, Coton Chad (set up in 1971), which carries out ginning – 90 per cent of it through nine factories that can handle 230 000 tonnes of cottonseed a year – has serious management and cashflow problems and has been losing money since 2002. Its deficit increased from 10 billion CFA francs ($14.4 million) to 22 billion ($37.9 million) in 2003 and then 30 billion ($56.7 million) in 2004.

The crisis worsened during the 2002/03 season, when it was unable to buy the entire harvest from farmers. Officially this was because the remaining 18 000 tonnes of cottonseed could not be collected because roads had been flooded by early rains. However a November 2004 report to parliament said nearly 8 billion CFA francs ($15.1 million) of the loan to fund the 2003/04 season had been diverted by the firm to repay supplier debts incurred in previous seasons. The quality inspection and sorting of the cottonseed by the firm also hurt growers and its ginneries and fleet of lorries are in poor condition and often break down because of poor maintenance. But bad roads are also a major problem, especially as farmers are widely scattered.

Privatisation in 2000 of the profitable oil-based soap business attached to Coton Chad deprived the firm of a major source of income as it produced for the local and sub-regional market and was thus sheltered from world price fluctuations. Farmers have also begun to turn away from cotton-growing with the arrival of oil, which offers better paid jobs, and also because the oilfields are next to the cotton areas in the wealthy south of the country.

OHADA rules would recommend closure of Coton Chad as uneconomic but privatisation is still planned for the state firm, in which the French company Dagris and small investors have a quarter of the shares. Tenders will be launched in 2005 for a sale of assets and the division of the firm into two parts, one in the east and one in the west. Farming structures will be organised so producers can possibly buy up to a third of the shares in the privatised company. About 162 million CFA francs ($306 100) has been raised for this so far. A $2 million World Bank funded cotton sector reform action plan was adopted at the end of 2004 after delays and could further postpone the privatisation planned for 2005.

Chad has suffered from severe electricity shortages for several years and firms and individuals mostly use private generators. The priority of the water and electricity production and distribution firm STEE is to improve supply to N'Djamena. The government is to repair some generating plants and to buy new ones to meet the demand. A long-planned new 25 MW power station is to be built in Farcha with a soft loan from the Islamic Development Bank since a projected link-up with the Cameroonian national grid has not yet materialised.

STEE is owned by the government (81.2 per cent) and the French Development Agency (AFD) (18.8 per cent) and employs 460 people. It was renationalised after the original buyer Veolia Water pulled out in August 2004 after only four months of managing it. STEE, which has been on the government's planned divestment list since 1997, had found a potential buyer in Vivendi after long negotiations. The privatisation was to be in two main steps with gradually increasing involvement of Vivendi, but things did not go beyond step one and the firm's accounts were not balanced.

The country's banks have been completely privatised, though the government has kept minority shares in some. The five original commercial banks – the BCC, CBT, BIAT, SGTB and the Financial Bank-Chad – were joined in 2004 by the Banque Soudano-Sahélienne pour l'investissement et le commerce. Customer deposits in these banks were 110.2 billion CFA francs ($208.2 million) at the end of July 2004. The SGTB is the biggest, with 27 per cent of the deposits, and dominates the market for current accounts by private bodies and private and public firms. The deposit/loan rate was 216 per cent in July 2004. Only 46.2 per cent of bank funds were used for loans, mainly short-term. The professional loan institutions association said 6.3 per cent of commercial bank loans were unsafe in mid-2004.

Access to clean water doubled from 16 per cent in 1990 to 34 per cent in 2002, but sewerage networks are still very poor. About 95 per cent of urban homes have no piped sewerage facilities and in 2000/01, only 37.6 per cent of town dwellers and 2.8 per cent in the countryside had running water. Urban access to clean water actually declined from 44 per cent in 1990 to 40 per cent in 2002.

Political and Social Context

The 1966 national constitution was significantly amended by parliament in 2004 to allow the president unlimited re-election instead of a maximum of two consecutive five-year terms and a referendum on the change is to be held on 6 June 2005 which the opposition has threatened to boycott. An attempt to kill President Idriss Deby failed on 16 May 2004 and was followed by government changes but no-one was prosecuted for the attack. Press freedom is quite good despite some setbacks but public demonstrations are often blocked by refusal of the legal permission required to stage them.

Chad was named as one of the world's most corrupt countries in Transparency International's 2004 report, which noted that corruption tended to be very high in oil-producing states, especially in the area of oil sector procurement. Chad was placed 142nd out of 145 countries on the corruption index, equal with Myanmar, just above Nigeria and below Cameroon (129th).

A year after oil production began, the government announced on 7 October 2004 it was suing the oil consortium for breach of contract and demanded more openness about the quality discount and transport costs, as well as the return to Chad of insurance policies established outside the country in violation of the rules of the Inter-African Conference on Insurance Markets (CIMA). The $25 base price used to calculate January 2004 oil revenue is also being disputed. Despite unprecedented official monitoring of the oil income, not all financial procedures are transparent, but inspection of government ministries that began in 2004 displayed a certain will to promote openness.

An increase in 2003 and 2004 in the number of local government units has not been matched by transfer of real responsibility and a building up of local infrastructure. Regional and general councils are not operating and municipal elections have still not been held. The government's intentions here will be tested in 2005. Good governance is the priority of the World Bank's upcoming Institutional Reform Support Credit programme in Chad.

Longstanding disputes between nomadic herdsmen and settled farmers in the south and southeast continue to disrupt the lives of people there. The farmers, mostly Christian or animist, are in conflict with the mainly Muslim herdsmen, who covet the farmers' fertile and oil-rich land. The fighting in Darfur, across the border in Sudan, has dragged on since early 2003 and the United Nations says the conflict has killed nearly 10 000 people and driven a million from their homes. A ceasefire was signed on 8 April 2004 between the Sudanese government and the rebels but the humanitarian situation is still very worrying in the refugee camps inside Chad, to which at least 150 000 people have fled.

A poverty reduction strategy paper (PRSP) was adopted in June 2003 after a broad national consultation process and led to proposals for a national good governance strategy. A progress report on the PRSP's implementation is being finalised. But political corruption and poor quality administration are hampering implementation of the measures.

Chad's population was estimated at 8.8 million in 2004. The last census was in 1993 and the one due in 2003 was cancelled for lack of funding, but a consumption and informal sector survey (Ecosit) is under way, with a report due in 2005. Results of a demography and health survey, updating a first one held in 1996, are also being analysed.

Fertility was steady between 1992 and 2002, at 6.7 children per woman of child-bearing age (15-49). Life expectancy at birth was an overall 47.7 years in 2002, but healthy life expectancy at birth was as low as 40.7, reflecting bad living conditions (including wars, violence and poverty). Under-5 infant mortality was very high – 202 per 1000 for boys and 180 for girls. Infant mortality in the first year of life was 112 per 1000. These figures put Chad 11th on the international list of countries with the worst infant mortality, well above all its neighbours except Niger.

A government-subsidised expanded vaccination programme (EVP) covered 72 per cent of the population in 2003 for tuberculosis (BCG) and 47 per cent for diphtheria, whooping cough and tetanus (DTP3). In 2002, 67 per cent of children had been vaccinated against TB and 55 per cent against measles.

The overall HIV/AIDS infection rate was 5.3 per cent (at the end of 2003) but 11 per cent among pregnant women between 15 and 25, much of it caused by their lack of information about the disease. Chad has about 96 000 AIDS orphans and a 200 million CFA francs ($380 000) government grant provides treatment for 83 people with anti-retroviral drugs. Malaria affected 21 per cent of the population in 2001, when only 2.2 per cent of children slept under treated mosquito nets and only 26.9 per cent under any mosquito net.

Only 8 per cent of women of child-bearing age used contraception between 1995 and 2002, 42 per cent of pregnant women got ante-natal care and 15 per cent gave birth in proper medical conditions. The low figures explained why Chad was one of the countries with the highest maternal mortality (827 per 100 000 live births).

There were only 3.3 doctors, 14.7 nurses, 2.3 midwives and 0.2 dentists for every 100 000 people in 1994; traditional practices persist (45 per cent of women between 15 and 49 have been genitally mutilated) and epidemics of cholera, meningitis and hepatitis E are common, along with malnutrition (44 per cent of children did not get the minimum daily calorific intake in 2002 and 28 per cent were underweight in 2000). These figures suggest that despite the end of the civil war, health conditions will not improve quickly.

The educational level is very low in Chad and the auditing firm Mazars and Guérard said in July 2003 it was the main cause of poverty. The weakness is reflected in gender and regional disparities. Female illiteracy was 58.9 per cent and male 42.6 per cent in 2004. Enrolment by age rose from 30.4 per cent in 1999/2000 to 32.4 per cent in 2000/01, meaning two-thirds of the school-age population do not go to school. Gross enrolment of 6-11-year-olds was 75.4 per cent in 2000/01, 3.8 percentage points up on 1999/2000.

Regional enrolment varies considerably, with 154.5 per cent in Logone Oriental province and only 16.6 per cent in Ennedi. Most children in the first year of primary school are aged between six and eight. The repeat rate is very high (25.5 per cent in 2000/01, down from 27.5 per cent in 1999/2000) and affected girls (28.6 per cent) slightly more than boys (26.8 per cent) in 1999/2000.

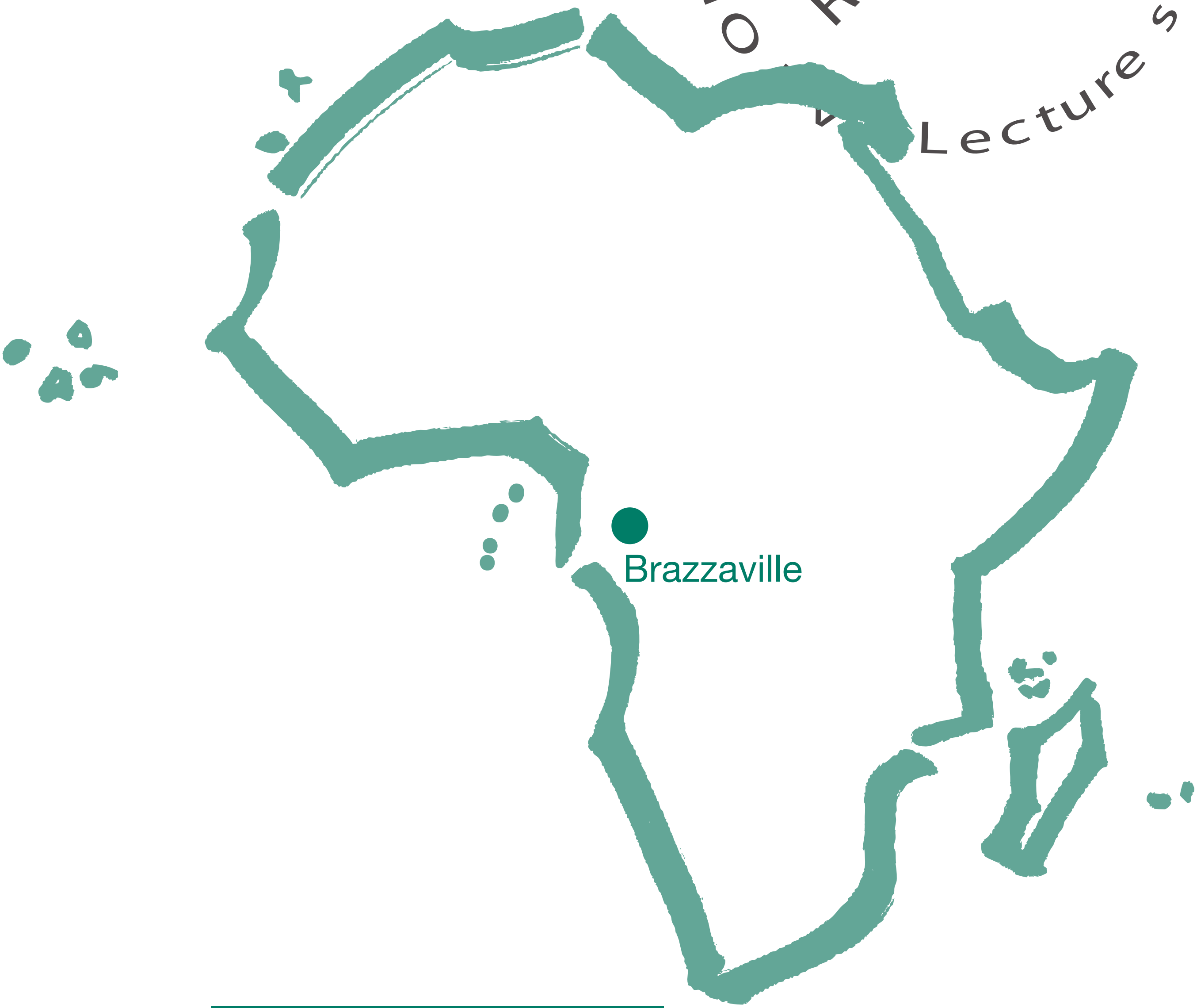
Serious gender disparity exists at all levels and in all types of education. Basic education covers 77.7 per cent of children, but only 38.7 per cent of these are girls. In secondary education (enjoyed by 12.8 per cent of children) only 23.2 per cent of students are girls and in higher education (which accounts for only 0.5 per cent of all students) only 14.5 per cent. The number of girls has risen 1 percentage point between 1999/2000 and 2000/01.

Most primary schools are state-run (54.2 per cent) or community-run (38.4 per cent) and only a few privately-owned (7.4 per cent). Most (84.1 per cent) are in the countryside, where they are mainly community-run, while 77.8 per cent of private schools are in towns. Nearly all schools (93.9 per cent) are French-speaking, with 3.7 per cent Arabic-speaking and 2.4 per cent bilingual.

The percentage of supply teachers hired rose 87.6 per cent in 2000/01 over the previous year while the number of permanent teachers increased only 3.7 per cent in 1999/2000, mainly in community-run (+19.3 per cent) and private (+4.2 per cent) schools. But the number of professional teachers fell by 1.6 per cent in state schools, while the pupil/teacher ratio rose from 68.6 to 71.2 (and ranged from 212 in Ennedi to below 55 in Borkou and Lac).

The number of schools increased by 607 (9.2 per cent) between 1999/2000 and 2000/01 but class size remained a concern – 63 pupils on average in 2000/01 and 71.1 for normal primary schools (without the double-shift system) and as high as 84.7 in the first year of primary school, thereby compromising early learning. A World Bank funded 11 billion CFA francs ($20.8 million) plan to build 1 000 classrooms throughout the country was launched in November 2004 under an educational reform programme (Parset).

Congo Republic



key figures

• Land area, thousands of km²	342
• Population, thousands (2004)	3 818
• GDP per capita, $ (2003)	957
• Life expectancy (2000-2005)	48.2
• Illiteracy rate (2004)	15.2

Congo suffered enormous damage during successive civil wars (especially between 1993 and 1999) but the oil sector, mainly-offshore, was spared. The fighting greatly increased poverty and the government became heavily indebted, in particular by mortgaging its oil resources. Since the end of the war in 1999 and elections in 2002, the economy has experienced a solid revival and growth should accelerate with the bright prospects of the oil sector.

Reconstruction and restoration of infrastructure were mainly financed with state funds at first, but the government has progressively restored links with the international community since 2003 for aid purposes. Strict control of public finances and major transparency efforts over oil revenue led to an International Monetary Fund (IMF) programme and an agreement with the Paris Club of lending nations in December 2004. The government aims to reach decision point under the Heavily Indebted Poor Countries (HIPC) Initiative in 2005.

The security situation remains fragile, however, and poverty widespread. The government will have to reconcile its commitment to macroeconomic stability with its promises of development and increasing social spending, in accordance with its new anti-poverty goals and the "social truce" it has signed with the trade unions. It will also have to make major efforts in governance and structural reform if growth is to be sustained.

Normalisation of financial relations has been achieved through improvements in the transparency of the oil sector.

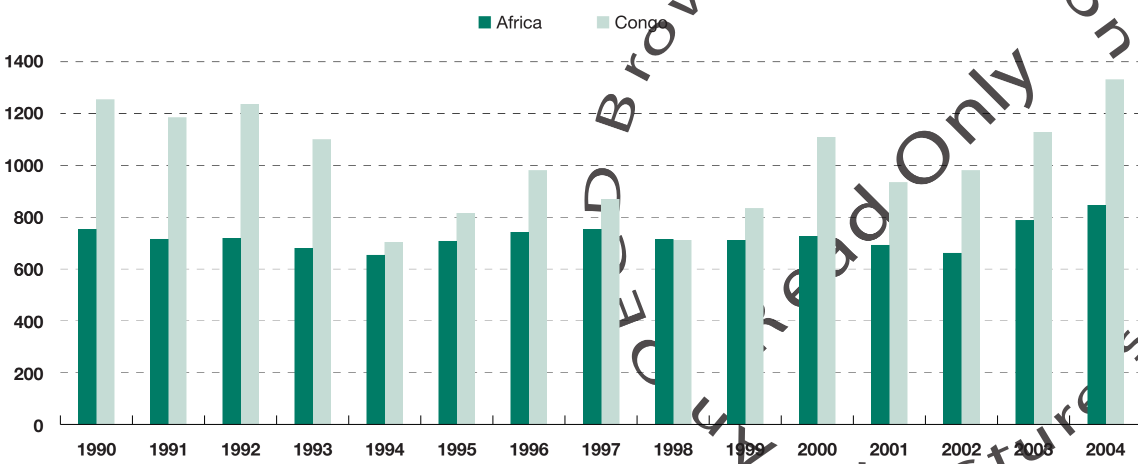
Figure 1 - **Real GDP Growth**

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

New oil discoveries boosted proven reserves in 2004, reversing a decline that began in 2000, and reforms have continued, especially in oil sector transparency – Congo joined the Extractive Industries Transparency Initiative (EITI) in June 2004 – and banking, where restructuring needs to be consolidated. Much work remains to ensure efficient basic services, such as water, electricity and transport.

Oil production declined up to 2003, but the non-oil sector forged ahead after the war ended and grew an average 12.5 per cent a year between 2000 and 2002, and 5 per cent in 2003 and 2004. Overall growth averaged 4 per cent a year between 2000 and 2004. Good prospects for the oil sector and vigorous activity in the rest of the economy should produce solid growth in

Figure 2 - **GDP Per Capita in Congo and in Africa** (current $)



Source : IMF.

coming years.

Recent Economic Developments

Congo is one of sub-Saharan Africa's oldest oil producers and its first oilfield (Emeraude) began operations in 1972. With output of 81.7 million barrels in 2003 and proven reserves of 1.5 billion barrels, it is the fifth biggest central African producer, after Nigeria, Angola, Gabon and Equatorial Guinea. Recent discoveries in the ageing M'Boudi field checked the steady decline in national production since 2000 and daily output increased by 20 000 to 25 000 barrels a day in 2004.

The oil sector, which accounts for half of GDP and 80 per cent of total export earnings, dominates the economy. The country has a refining capacity of 21 000 barrels a day, so can process part of the output locally. Relations between the government and the companies have depended since 1995 on production-sharing agreements. The government sells its share through the state oil company SNPC (set up in April 1998) and this provides around 70 per cent of its annual revenues.

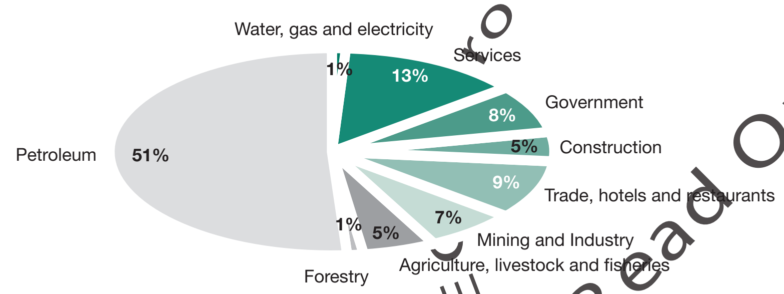
Timber was the main export before the 1973 oil boom and the government is careful to encourage job creation in the sector and properly manage the forest environment. A new forestry code regulates local processing of wood, which will involve 85 per cent of production by 2007. Log production was about 1.35 million cubic metres in 2004, up 5 per cent on the previous year. Saw milling has increased sharply since firms have been obliged to process locally part of their output under the forestry tax reform. Production of sawn wood, veneer and plywood rose from 206 900 cubic metres in 2003 to 221 700 in 2004.

The country has great hydro-electric power potential, mainly on the Kioulou river, in the south, and in the north at Imboulou, on the Léfini river, and Dja. Only 35 per cent of installed capacity is used and production is far below national demand. Despite imports from the neighbouring Democratic Republic of Congo, power cuts are very frequent.

The secondary sector has withered in the face of oil-related activities and only accounts for 13 per cent of non-oil activity. Sugar production rose sharply in 2004 however and the sugar company Saris was left with large stocks because of problems in getting it by rail to Brazzaville. Rail traffic is hampered by a shortage of wagons and the poor state of the track. The private sector has had no major projects since 2001, when large-scale restoration of damaged infrastructure was done, and the construction sector continues to be depressed since a recent cutback in government investment.

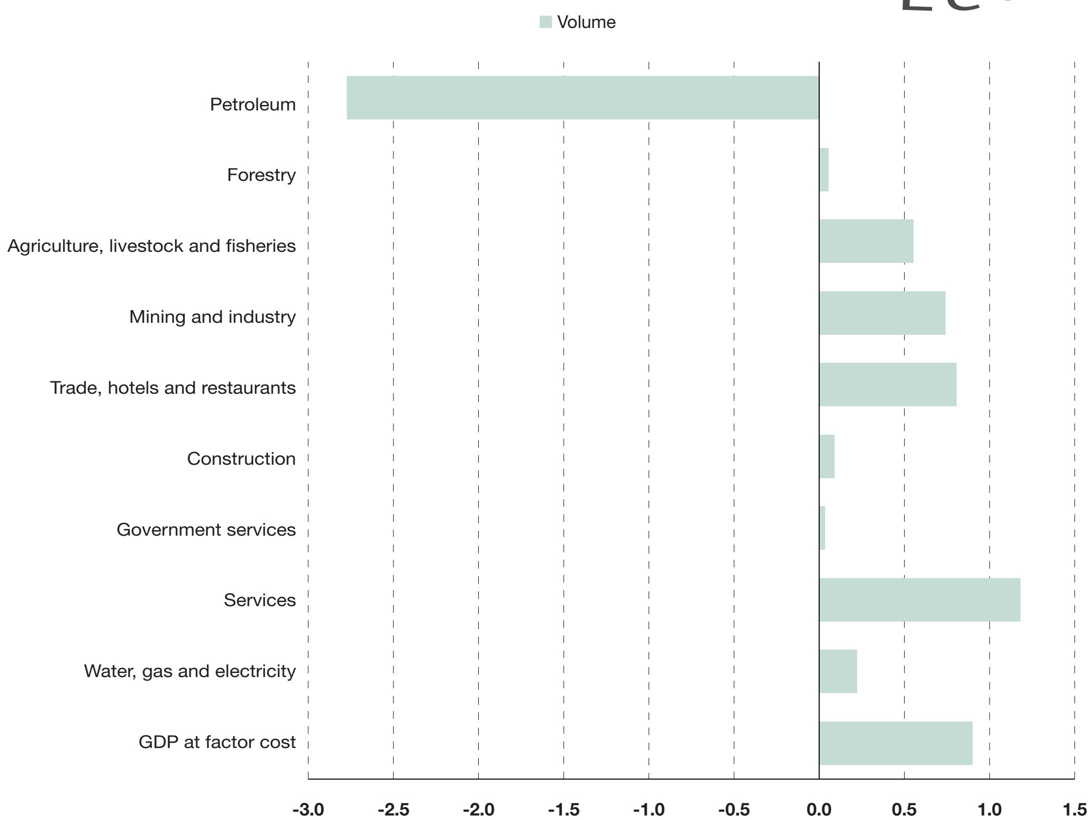
The services sector, about a third of GDP, drove

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on IMF data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on IMF data.

growth in 2003 with vigorous activity in commerce and, in particular, telecommunications. The national insurance company, ARC, had a monopoly between 1975 and 1998, but the insurance sector – regulated within the framework of the Franc Zone's Inter-African Conference on Insurance Markets (CIMA) – has since been opened up to competition and other firms have begun operating, such as the local AGC (January 2000) and the Ivorian NSIA (December 2004).

Telecommunications, monopolised since 1960 by the state-owned ONPT (which became Sotelco), has been opened up to private mobile phone companies such as Cyrus (1996), Celtel Congo (December 1999) and Libertis Télécoms (second half of 2000). The number

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**32.2**	**26.4**	**23.3**	**23.2**	**22.9**	**20.6**	**21.5**
Public	12.6	10.0	8.6	6.6	6.3	5.7	5.9
Private	19.7	16.4	14.7	16.6	16.6	14.9	15.6
Consumption	**52.7**	**46.9**	**50.0**	**51.7**	**47.7**	**41.8**	**42.7**
Public	15.4	14.1	18.4	17.3	15.9	14.1	14.8
Private	37.3	32.8	31.7	34.4	31.8	27.7	27.9
External sector	**15.0**	**26.6**	**26.7**	**25.0**	**29.4**	**37.6**	**35.8**
Exports	67.8	80.1	80.7	78.8	79.5	81.4	79.9
Imports	-52.7	-53.4	-54.0	-53.8	-50.1	-43.8	-44.1

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

of telephone subscribers increased from 10 000 in 1999 to nearly 350 000 in 2004 and the mobile phone network now covers areas not served by fixed lines.

Economic change is largely conditioned by the growth of the oil sector. Production had fallen in recent years but new discoveries halted the decline and in 2004 the sector once more became the engine of growth. Demand in non-oil sectors is limited by stagnant incomes, in particular a freeze on the salaries of civil servants (the main part of the workforce) for the past few years.

Macroeconomic Policies

Fiscal and Monetary Policy

As a member of the Central African Economic and Monetary Community (CEMAC), Congo uses fiscal policy as its main instrument of macroeconomic stability. The country did not meet regional convergence criteria in 2003 for debt ratios and absence of debt arrears, but showed an improved performance overall.

Congo has used its big rise in oil revenue in the past two years to restore balance to public finances and improve their management. The oil sector provides almost 70 per cent of government income and the non-oil sector provides limited tax revenues. These efforts at discipline have made it possible to reopen links to foreign funding agencies and the country has begun to pay off its external debt. But the problem of huge domestic arrears in payments due to civil servants and government suppliers is barely closer to solution, despite a signed "social truce" between management and trade unions.

The primary budget surplus rose from 0.3 per cent of GDP in 2002 to 6.1 per cent (2003) and 9.6 per cent (2004) due to exceptional oil revenue and strict control of overall spending. Oil revenue grew in 2003 and 2004, despite almost stagnant production, because of a sharp rise in world prices and payment of $145 million received in 2003 to settle a dispute with one of the oil companies.

Total expenditure fell nearly 6 percentage points of GDP (from 35.5 to 29.7 per cent) between 2002 and 2003 and should fall further in 2004, to 26.7 per cent. These cuts, to both current and capital expenditure, were the result of a major effort to centralise budget decisions and monitor payments. As a result, reconstruction work begun in 2000-02 slowed significantly. However the budget continues to suffer from cashflow problems and arrears have built up, notably debts to the Democratic Republic of Congo for electricity imports.

The authorities are now handling oil revenues much more transparently. Oil future sales stopped in 2002 and the companies (including the state-owned SNPC) are banned from spending on the government's behalf. Since 2003, oil revenue has been certified every quarter by an independent audit firm and the SNPC's accounts are systematically inspected. These checks have revealed

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Total revenue and grants[a]	**28.1**	**30.9**	**27.4**	**30.1**	**31.7**	**31.7**	**27.5**
Tax revenue	9.9	8.3	7.7	8.7	8.8	8.1	8.1
Oil revenue	17.6	21.8	19.4	20.7	22.4	23.1	18.9
Total expenditure and net lending[a]	**38.7**	**31.6**	**35.5**	**29.7**	**26.7**	**23.6**	**24.2**
Current expenditure	25.7	21.6	26.8	23.1	20.4	17.9	18.3
Excluding interest	*13.0*	*14.1*	*18.4*	*17.3*	*15.8*	*14.1*	*15.0*
Wages and salaries	8.2	5.8	5.7	5.9	5.4	4.7	4.7
Interest	12.8	7.4	8.4	5.8	4.6	3.8	3.3
Capital expenditure	13.0	10.1	8.6	6.6	6.3	5.7	5.9
Primary balance	**2.1**	**6.7**	**0.3**	**6.1**	**9.6**	**11.9**	**6.6**
Overall balance	**-10.6**	**-0.7**	**-8.1**	**0.4**	**5.0**	**8.1**	**3.3**

a. Only major items are reported.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Oil revenue: what does the government get?

Production-sharing agreements were signed between the government and the oil companies (posted in full on the government's website) and vary from one oilfield to another. Oil taxes are calculated on the basis of cost oil (investment spending), cost stop (a ceiling on reimbursement of oil costs) and, in some contracts, a bonus (varying according to the contract) when prices of crude rise above $22 a barrel.

Oil revenue comprises the tax (12-15 per cent) and oil-profit, which depends on the government's agreed share and can increase above a certain level of production. It varies between 20 and 63 per cent according to the contract. When prices are high, the government can claim up to 90 per cent of the difference between the fixed price and the higher one. In the PNGF and Madingo fields (60 per cent of total output), the government's oil-profit rises faster than the barrel price when the latter is above $26, but is stable below $10 and between $14 and $26. This increases the apparent oil tax base.

large extra-budgetary transactions. The government posts regular detailed information about the oil sector on its website, including recently an account of a controversial financial settlement with a company in 2003.

These public finance management efforts have enabled Congo gradually to normalise its financial relations with the international community. Between January and June 2004, the country complied with performance criteria set under a standard IMF-monitored programme. This led to a poverty reduction and growth facility (PRGF) programme in December 2004 and agreement with the Paris Club creditors the same month. Strict compliance with the PRGF should enable the government to reach its goal of HIPC decision point in 2005, so it can settle its external debt arrears and regain access to new development funding.

The government plans, through careful management, to boost its anti-poverty spending in 2005 while servicing its external debt. The 2005 budget, drafted when world oil prices were very high, is conservatively based on an average $31 barrel price for the year and on only a small rise in oil revenue – less than one percentage point of GDP in 2005, despite a big expected production increase of 17 per cent.

Under the plan, current spending will fall below 18 per cent of GDP but will reflect the priorities of the interim poverty reduction strategy paper (PRSP) finalised in last-quarter 2004. So anti-poverty spending, especially for health, primary education and rural roads, is growing strongly (from 4.7 per cent of GDP in 2004 to 5.9 per cent in 2005) while all other spending is on hold. The resulting primary surplus (11.9 per cent of GDP) will enable repayment of domestic and external arrears to be speeded up, with extra help from additional oil revenues.

Congo has accumulated major domestic arrears of about 230 billion CFA francs ($396.7 million –11 per cent of GDP at the end of 2003), which includes the social debt (23 months of arrears of salaries, pensions and benefits to workers of disbanded state firms) and the commercial debt, much of it to government suppliers. The government will submit audits already carried out on the commercial debts for checking by firms hired by international tender and get the social debt confirmed by the government's general financial monitoring unit. The 2005 budget earmarks 50 billion CFA francs ($98.8 million) for paying off domestic arrears but this will not be paid until they have been verified and certified and a transparent and fair repayment plan drawn up.

The cautious regional monetary policy of the Bank of Central African States (BEAC) limited Congo's inflation to 1.2 per cent in 2003 and 2 per cent in 2004, despite a sharp rise in transport costs in the first half of 2004.

External Position

Congo's main trading partners are the United States and China, to which it mainly sells oil and timber. A third of all imports come from France. Oil exports by the local Coraf refinery in third-quarter 2004 were 5.1 million metric tonnes (slightly down from 5.2 million in 2003). Volume exports of logs rose 22.8 per cent in the first half of 2004 year-on-year and sawn wood, veneer and plywood 16.9 per cent. Total imports were expected to increase due to renewed economic activity in 2004, but the trade surplus grew from 49.2 to 52.2 per cent of GDP. The current account returned to surplus due to better trade and transfer balances.

Congo is one of the world's most indebted countries per capita as a result of a decade of war and poor debt policies. The external debt was $8.6 billion at the end of 2003 – 243 per cent of GDP and 70 per cent of it arrears. Bilateral debt was 58 per cent of the total, commercial debt 34 per cent and debt to multilateral creditors 8 per cent. The commercial debt includes debt secured to oil revenue that was mostly contracted during the war years. Debt service relative to government revenue remains very high (46 per cent in 2003, 37 per cent in 2004). Repayment can only be done with special international help, so the government intends to normalise relations with its creditors.

The government had many meetings with bilateral and multilateral public creditors in 2004 to this end. A meeting with the Paris Club on 16 December resulted in rescheduling of the bilateral debt under Naples terms, including cancellation of two-thirds of it ($1.6 billion), and special treatment of arrears that cannot be rescheduled (reprofiling over three years), after arrears to multilateral creditors have been paid off, two-thirds of the amount covered by external budget aid.

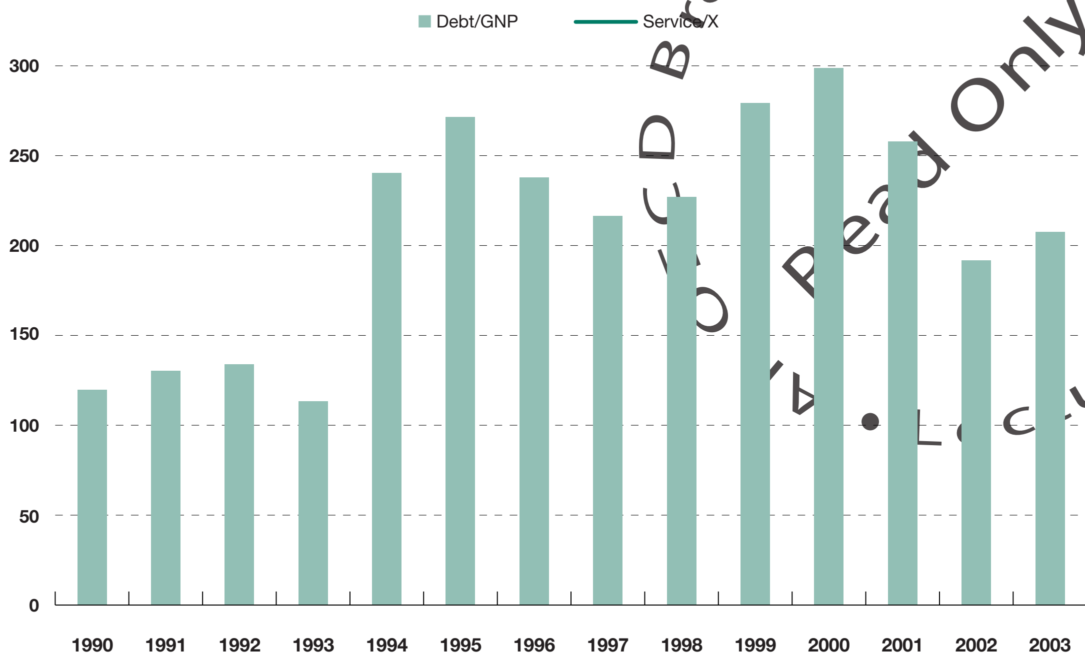
The government should also get a 90 per cent

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Trade balance	42.4	49.3	51.1	49.2	52.2	57.5	55.9
Exports of goods (f.o.b.)	65.7	73.7	74.5	72.3	74.1	76.8	75.3
Imports of goods (f.o.b.)	-23.3	-24.4	-23.4	-23.1	-21.9	-19.3	-19.4
Services	-33.5	-22.6	-24.4	-24.4			
Factor income	-43.2	-29.9	-27.1	-25.2			
Current transfers	1.2	0.1	0.1	0.2			
Current account balance	**-33.1**	**-3.2**	**-0.3**	**-0.1**			

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

multilateral debt reduction from the Paris Club in 2005 under the HIPC Initiative and has said it will ask other bilateral and commercial creditors for similar treatment. But this is far from certain, as the funds that hold much of the commercial debt are taking legal action to obtain repayment of the debt's original value.

Structural Issues

Congo's private sector is still marked by decades of a planned economy and by the various conflicts and wars that have ravaged the country. The economy's competitiveness is handicapped by inefficient public services, such as water and electricity, and the dilapidated state of most infrastructure, especially roads.

The corrupt and dysfunctional legal system needs to be strengthened and made more independent, the tax system streamlined and government corruption in the customs service tackled. Some progress has been made with the setting up of new courts and renovation of their buildings but they are not yet operating for lack of money. A one-stop administrative office, the CFE, has been open since 1995 for those wanting to set up businesses and has greatly reduced the time taken to do so.

Government figures put the number of formal sector companies at 2 100 and of informal sector firms at more than 10 000. The formal sector had 40 421 workers, according to an employment survey, mainly in the services sector which also has the most employees in the private sector. This is confirmed by CFE figures that show 97.5 per cent of new business applications in 2003 were in the services sector. The CFE said 1 942 firms were set up during that year, 1 743 of them individual ones. The number rose sharply in the first half of 2004, when the CFE had already registered 1 870 applications and 1 186 new firms had been set up.

Most big firms (banks, breweries, distribution, telecommunications) are concentrated in Brazzaville and Pointe-Noire, the economic capital, where the main export companies are located because of its port. Non-individual firms are reckoned to employ more than 70 000 people. Most firms (78 per cent) have fewer than five workers and 6 per cent have an annual turnover of less than 1 million CFA francs ($1 900). Only eight have more than 500 workers and only 21 a turnover of more than 5 billion CFA francs ($9.4 million). The informal sector is large and some of it is run by immigrants from elsewhere in West Africa and by Lebanese.

The banking system has been restructured and is in much better shape but still fragile. Commercial bank loans (8 per cent of GDP) go almost entirely to big firms. So micro-credit is indispensable and extensively used for borrowing. It has become more widespread with the rapid growth of co-operatives – the Mucodec associations – that hold nearly 10 per cent of total loans to the private sector. They are supervised by the BEAC's Central African Banking Commission (Cobac) and have solid financial ratios. Their short-term loans are increasing by 2.5 per cent a month and they have some 150 000 active members in a network of 30 local offices. The number of their loans has risen very quickly (23 per cent in 2004) but they have managed to keep unsafe loans at a minimum through a strict guarantees policy.

Much work remains to be done before the process of privatising the first state companies can begin. Only the banking sector has been completely restructured and is now entirely in private hands. Serious delays have plagued the rest of the programme, especially in respect of public services such as water, electricity and transport, which continue to deteriorate.

Hydro-electric plants were very badly damaged during the civil war and the country has severe electricity and water shortages. Only 56 MW are produced, about half the 109 MW combined capacity of the two hydro-electric plants, at Djoué (14 MW) and Moukoukoulou (70 MW), and a 25 MW gas-fired power plant at Djeno opened in 2002. The decrepit equipment of the state electricity firm SNE operates at only a third of its capacity. The gap between supply and demand causes many power cuts, so the government has signed a contract with the neighbouring Democratic Republic of Congo's electricity firm SNEL to supply 35 MW (and perhaps eventually 45MW) from the Inga hydro-electric plant. But Congo had accumulated $28 million of arrears to SNEL by the end of 2002.

The government plans, with Chinese funding, to build a $236 million 120 MW hydro-electric dam at Imboulou, on the Lefini river 210 km north of Brazzaville. About 15 per cent of the money has been

The Oil Sector Starts Funding SMEs

The private sector and funding agencies are trying to ease the ready-capital problems of small and medium enterprises (SMEs).

The Pointe-Noire industrialists' association Apni,[1] which includes the French oil firm Total and two local commercial banks, has funded technical and professional training centres, a business information centre for SMEs in Kouilou province (October 2003), officially registered management advice centres (February 2004) and surveys to help the private sector organise better. Apni presented a project in February 2004 for an investment company to give SMEs easier access to medium and long-term loans.

The French Development Agency (AFD) has also proposed a loan guarantee arrangement (the Ariz Fund) to local banks to help them provide more medium and long-term credit to SMEs and to enable SMEs to buy shares in their subsidiaries.

Despite these efforts, funding facilities for agriculture are still lacking and there is little leasing or factoring.

1. The organisation grew out of the Point-Noire Industrial Project launched in July 2002 with the local chamber of commerce, industry, agriculture and professions and with some large industrial and commercial firms.

disbursed and the rest will be in the form of supplier credits repayable over 15 years, with a five years grace period and less than 1 per cent interest. Another thermal power station of 30 MW may be built in Brazzaville to meet needs until the dam is built. Repairs to the high-voltage line between Moukoukoulou and Brazzaville should start soon. A proposed Belgian-funded coal-powered plant may also help supply.

In view of the government's financial problems, the fully state-owned SNE is being put up for franchise, but with 1 385 workers, it is a sensitive area of the economy. A first privatisation attempt failed in 2001 when no bids were deemed suitable. The plan now is to modernise the grid and improve the firm's finances before offering it for sale again. Potential investors are deterred by its dilapidated condition, war damage to equipment, outdated machinery, its social debts and its overstaffing. In 2000, it owed its workers 5.1 billion CFA francs ($7.2 million) in salary arrears and 9.3 billion ($13.1 million) in social security contributions. The system of lump-sum billing encourages abuse and households use a large amount of electrical kitchen equipment and shun gas appliances.

The CFCO railway company is also to be privatised. The primitive state of the roads makes rail or air the only feasible way to travel between the major centres of Brazzaville and Pointe-Noire. CFCO's good management and profitability make privatisation an option and the plan is to offer a 25-year franchise with an option to extend. Tenders were received from a South African consortium, Sheltam-Mvela, and a European group, Congo-Rail (Bolloré-Maersk-Comazar-SNCF), but the financial terms could not be agreed . The line has been made significantly safer but freight traffic is still very slow (15-20 km/hour) and dangerous. Armed bandits mostly target goods but passengers are still at risk and only freight traffic has resumed since the last attack in October 2004. With very bad and dangerous roads, air is the only dependable and safe way of travelling between the two cities.

Political and Social Context

After a decade of war, stability of sorts returned to the country with the signing of a peace agreement in Pointe-Noire in November 1999, another in Brazzaville the following month and a subsequent national dialogue between all parties involved. Peace and stability were boosted with the holding of elections in 2002 and a peace agreement with the last rebel groups in March 2003. The government also signed a two-year "social truce" with the country's trade unions in 2003.

But security remains fragile, especially in the Pool region, southwest of Brazzaville, where it has not been possible to hold by-elections for its seven parliamentary seats since 2002. The next parliamentary elections are due in 2007 and a presidential poll in 2009. A cabinet reshuffle in January 2005 saw the departure of the minister of economy, finance and budget.

With the return of peace, restoring security nationwide is a major challenge. A body to reintegrate the former combatants into civilian life has been set up and will work largely in the Pool region. The disarmament and reintegration programme has foreign funding and the European Union, with the World Bank, is dealing with the return of former child soldiers to civilian society. People displaced by the fighting are beginning to return to their homes and resume farming activity.

The government has been a member of the Extractive Industries Transparency Initiative (EITI) since 2004 and Congo has made more progress than most African states in respecting these standards, according to the World Bank. Transparency in managing oil revenue has indeed greatly improved. Congo is also trying to return to the Kimberley Process scheme (for preventing diamonds from conflict areas being sold on the legitimate market to finance wars), from which it was excluded in July 2004, and a meeting of diamond-producing countries was held in Congo from 11-15 November 2004. Transparency International placed Congo 114th out of 145 countries in its 2004 corruption index, better than other oil-producing countries such as Nigeria, Chad and Cameroon, but the country's rating indicates corruption remains endemic.

The government has done a poverty survey and drawn up a list of priority action areas as part of its interim PRSP poverty reduction strategy, for which there was much consultation, including in the provinces (most of the many non-governmental organisations in the country are in Brazzaville and Pointe-Noire). The government needs urgently to increase budget spending in these priority areas.

Two-thirds of Congolese live below the poverty line, according to the World Bank, compared with only 30 per cent before fighting broke out in 1993. Congo slipped more than 12 per cent on the UNDP's Human Development Index during the civil war. According to UNICEF, 11 per cent of children under 15 are orphans and 60 000 women and girls were raped during the war, in which 5 000 children fought. It also said 70 000 people still need urgent humanitarian aid.

The steady growth of the population (3.4 per cent a year between 1975 and 2002) and continuing high fertility (6.3 children per woman of child-bearing age) could reflect persisting major political and social instability encouraging women to have a large number of children. In 1999 17 per cent of rural and 72 percent of urban households had access to clean water .

Life expectancy at birth was put at 48.9 years in 2004. Maternal mortality (510 per 100 000 live births) and infant mortality (81 per 1 000) remain very high. HIV/AIDS infection affects between 5 and 12 per cent, according to various sources. Reliable data on this are hard to get, but the disease is clearly spreading fast, judging by the country's nearly 100 000 AIDS orphans. HIV infection is especially high in Pointe-Noire. Fewer than 500 adults were getting anti-retroviral treatment in June 2004.

An expanded vaccination programme (EVP) covered 60 per cent of the population in 2003 for tuberculosis (BCG), 50 per cent for diphtheria and tetanus (59 per cent of children are born with natural immunity to tetanus thanks to their mothers' antibodies), 50 per cent for polio and 50 per cent for measles.

Missed immunisation opportunities remain high, affecting 12.8 per cent of children and 50 per cent of mothers, according to a 1998 survey. In a third of the cases, vaccine was unavailable and 36 per cent of the children were ill, so health workers need to redouble their efforts to get mothers to have their children vaccinated. Missed opportunities are higher among women than children and women must be persuaded to be vaccinated by stressing the automatic immunisation of the child with vaccination during pregnancy. Vaccination rates against measles for children under a year old fell from 75 per cent in 1990 to 38 per cent in 1995 and 37 per cent in 2002.

The wars sharply reduced primary and secondary school attendance, which dropped from 81.6 per cent in 1990 to 51.6 per cent in 1998. But enrolment recovered very fast and in 2001/02 was 86 per cent in primary schools. Literacy remains high – an average 80 per cent, and 97.8 per cent for the 15-24 age group, but plenty remains to be done. Total secondary enrolment fell by 6 per cent in 2002 year-on-year due to a sharp drop (18.2 per cent) in the number of girls and large variations between provinces. Primary enrolment was up in Brazzaville, Pool and Niari, but stable in Cuvette-Ouest and Lékoumou and down in Likouala.

Children do not have equal access to education: 68.5 per cent of pygmy children between 6 and 14 have never been to any kind of school and most children out of school are girls (highlighting the relevance of looking at education in gender terms). Dropout rates are also very high and less than a third of schoolchildren complete primary school. Preschool education is expanding, however, even though enrolment is still low (4.9 per cent in 2002), and the number of pupils rose from 6 033 in 1999 to 15 714 in 2002. The start of the new school year went better in 2004 than previously, despite persistent organisational problems that meant children had to enrol over a period of several weeks and sometimes months.

Educational infrastructure is lacking, with an average of four children seated at each form-desk in state schools and 1.3 in private schools. An average of 57 children share an arithmetic book in state schools and eight in private establishments, while 18 and four share a reading book in state and private schools respectively. Six of the country's 11 administrative units have more than 50 children per class in state schools and in three there are more than 100 children per teacher.

Many teachers died in the wars and schools were looted and destroyed. Only 5 596 classrooms were operating after the war ended, compared with 6 425 in 1997. A national education plan lists priorities and literacy targets, but the government does not yet have a sector strategy or overall educational administrative plan, though these are government priorities. A World Bank project aims to equip 400 classrooms, provide free education and school books and encourage enrolment

Democratic Republic

key figures

- Land area, thousands of km² 2 345
- Population, thousands (2004) 54 417
- GDP per capita, $ (2003) 108
- Life expectancy (2000-2005) 41.8
- Illiteracy rate (2004) 33.2

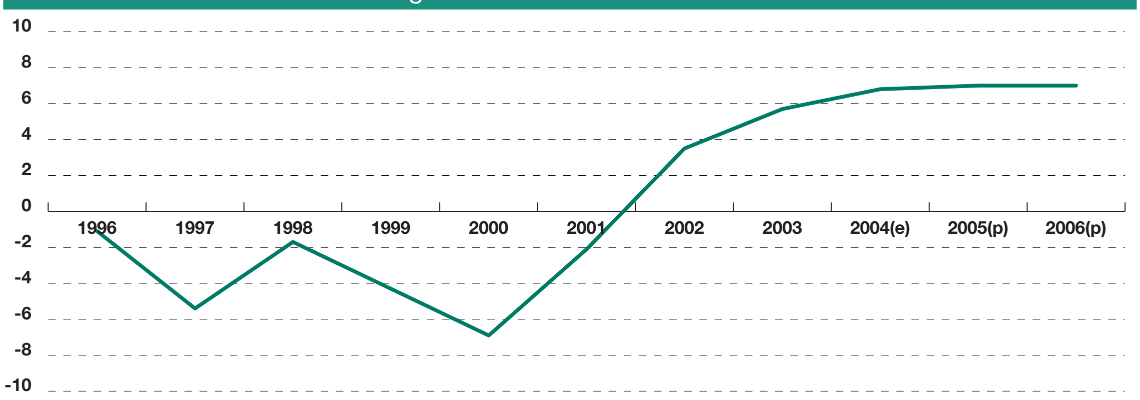
The Democratic Republic of Congo (DRC) has one of the richest natural resource endowments in the world, with mining, forestry and hydro-electric sectors offering enormous growth potential. The domestic market is considerable, as the country has a population of more than 50 million, but ten years of war have devastated its economy, infrastructure and social fabric. During this period of conflict, more than 3 million people died, the incidence of HIV/AIDS soared and human development indicators such as malnutrition, life expectancy and literacy deteriorated very sharply, to levels worse than those observed prior to independence in 1960.

Since 2001, peace has been re-established over much of the country, although the fighting persists in some areas in the east. The government has also introduced a policy of economic stabilisation, which has achieved considerable progress: hyper-inflation and currency depreciation have been brought under control; and economic growth, which revived in 2002, exceeded 6 per cent in 2004. In June 2002, following the encouraging results of the enhanced interim programme (RIP), the Bretton Woods institutions (the IMF and World Bank) granted a $1.2 billion credit to support the government's economic programme. The programme, which runs from April 2002 to July 2005, aims to liberalise prices and trade, reform the banking sector and exploit growth possibilities such as those offered by diamond production.

Consolidation of the peace process is vital for economic recovery.

The political situation remains delicate, however, and tensions persist at the border with Rwanda, in Ituri, Nord-Kivu and Sud-Kivu. Elections, initially

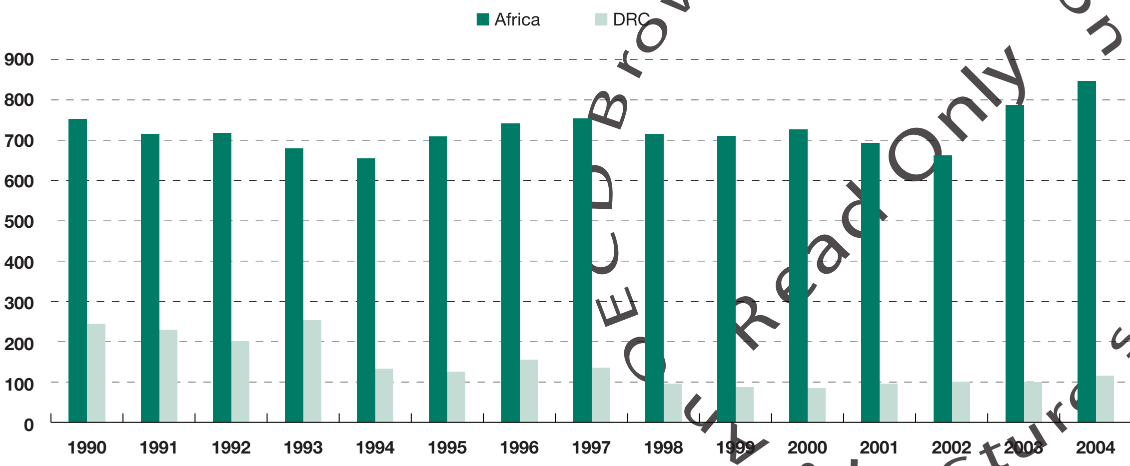
Figure 1 - **Real GDP Growth**



Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

scheduled for June 2005, cannot be held unless the government re-establishes control over all provinces. In this situation, if macroeconomic stability is to be sustained, the government must reduce public spending, although the funding requirements of reconstruction, peacekeeping and poverty reduction are putting the budget under heavy pressure. If the government succeeds in preserving political stability, improving governance, combating corruption and pursuing structural reform to improve the business climate, DRC could return to very high rates of growth.

Figure 2 - **GDP Per Capita in DRC and in Africa** (current $)



Source: IMF.

Recent Economic Developments

Lack of political cohesion and repeated armed conflicts engendered an economic recession during the 1990s. As is always the case in post-war situations, the trend was subsequently reversed, with a GDP growth rate of 3.5 per cent in 2002 and 5.7 per cent in 2003. According to the information available, economic growth rose to 6.8 per cent in 2004 and could reach 7 per cent in 2005 and 2006, thanks to the recovery in national and foreign investment.

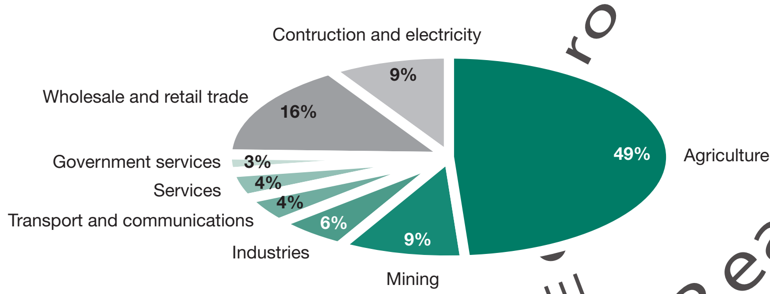
DRC has 80 million hectares of very rich arable land, but owing to the deterioration in infrastructure, farmers' lack of capital and the absence of government support policies, only 1 per cent of it is cultivated. Although the agricultural sector accounts for nearly half of GDP, this is only because of the sharp fall in manufacturing and mining output during the years of conflict, since output of the main crops (corn, paddy, root vegetables and tubers, beans, plantains and fruit) has decreased in volume. Farmers have gone back to traditional techniques, without fertilisers, and are using family labour. As a result, most of the traditional crops, except coffee and timber, have disappeared from the export list and food production does not cover the needs of the population. Despite the improvement in supply and links between the capital and producing areas, farm output has increased only slightly since the return of peace, rising just 0.4 per cent in 2004.

The energy sector has suffered from the deterioration in economic conditions, and its contribution to GDP was estimated at less than 4 per cent in 2003. Only 5.7 per cent of the population has access to electricity, although DRC's theoretical production capacity of 1 120 MW is enough to cover the needs of the whole country, as well as those of some neighbouring countries. Despite a slight improvement in the last few years, power production remains far below the level of the 1990s. Crude oil production stood at 9.3 million barrels in 2003, but DRC possesses some offshore reserves that could be tapped in the near future.

Some 50 minerals have been discovered in DRC, but the principal state-owned enterprise, Gécamines, mines only ten of them: copper, cobalt, zinc, diamonds, gold, tin, niobium, manganese, iron and lithium. All mining output is exported, and the sector is the country's main foreign currency earner. The desire to appropriate DRC's mineral wealth was unquestionably one of the main causes of the recent war. In particular, the Kasai diamond-producing region has been hotly contested, with neighbouring countries observing and joining in the fighting so as to control diamond production and trade, and thus obtain foreign exchange. In this situation, diverging interests could make it difficult to implement the peace agreement.

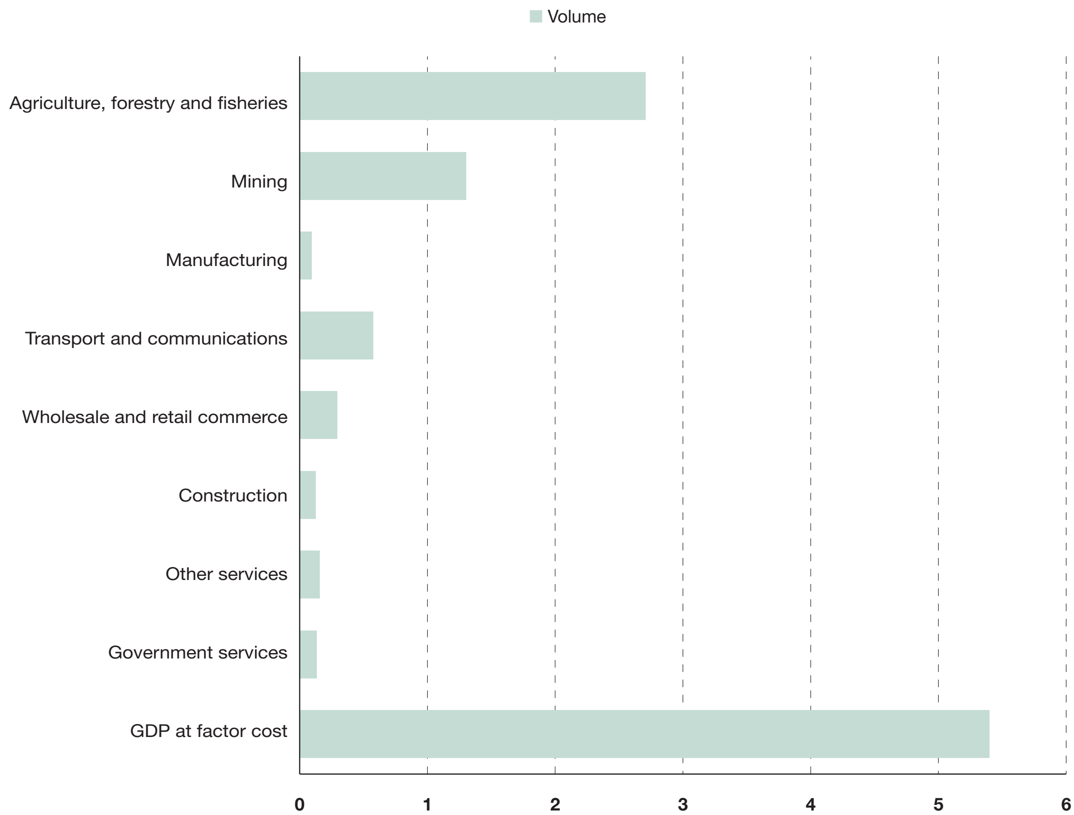
The contribution of the mining sector to GDP was estimated at 9.4 per cent in 2003, but the sector registered

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on Central Bank data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on Central Bank data.

growth rates of over 10 per cent during the 2002-04 period. Diamond production, in particular, showed strong growth following deregulation of the sector in 2001. In 2003, it reached a total of 27 million carats, having a value of $584.4 million. Diamonds are the principal export product in DRC, accounting for more than three-quarters of export revenues. The other significant export products are copper and cobalt. The figures are approximate, however, since diamond production and export are largely informal. Despite efforts to limit tax evasion, the taxes paid by diamond dealers are marginal since the sector largely escapes taxation.

The industrial sector accounted for 5.6 per cent of GDP in 2003. Formerly of considerable size, it consists today of a few small plants producing textiles, food, chemicals and capital equipment. All industrial branches have suffered from the crisis which hit the country. Manufacturing industries, cut off from their sources of raw material supply and their markets for finished goods, currently use only 15 to 17 per cent of installed production capacity.

The services sector is dominated by transport and telecommunications. Although the conflict seriously degraded the quality of road, river and rail infrastructure, the recovery which began in 2003/04 strengthened demand for public transport in the major cities. The telecommunications sector is developing through expansion of mobile telephone service, which links the major cities via GSM. The sharp increase in the number of subscribers, which rose from a few thousand at the start of the decade to 700 000 by 2004, has had a major impact on GDP. In the context of reconstruction, particularly of the road network, the construction sector has also registered high growth rates (around 20 per cent during the last two years).

Although low levels of savings and investment have held up growth over the last two decades, encouraging signs have appeared since the end of the war. Total savings rose from 3.2 per cent of GDP in 2001 to 12.3 per cent in 2004. Investment rose from 5.3 per cent of GDP in 2001 to an estimated 18.5 per cent in 2004, making it the principal factor in the resumption of growth. This movement can be attributed to reconstruction of infrastructure, financed by development aid and private investment (notably in telecommunications).

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)
Gross capital formation	**24.2**	**5.3**	**9.1**	**12.3**	**18.5**
Public	0.5	0.1	1.0	2.7	5.1
Private	23.7	5.2	8.2	9.6	13.4
Consumption	**67.6**	**96.8**	**95.9**	**94.3**	**87.7**
Public	6.2	6.9	6.2	5.8	6.2
Private	61.4	89.9	89.7	88.5	81.5
External sector	**8.2**	**-2.1**	**-5.0**	**-6.6**	**-6.2**
Exports	30.9	18.8	21.6	25.3	29.7
Imports	-22.7	-20.9	-26.6	-31.9	-35.9

Source: IMF data; estimates (e) based on authors' calculations.

Macroeconomic Policies

Fiscal and Monetary Policy

The introduction of restrictive macroeconomic policies has brought inflation under control, but political pressure for a rapid increase in public spending remains very strong.

Since 2001, the budget deficit has increased sharply, from 1.7 per cent of GDP in 2001 to 3.9 per cent in 2003 and nearly 5 per cent in 2004. It is projected to reach 5.6 per cent in 2005. The budget is heavily dependent on external resources in the form of grants and loans, which since 2003 have exceeded the state's own revenues. Grants rose from 2 per cent of GDP in 2003 to 3.6 per cent in 2004. Direct budget support, provided by the World Bank and the African Development Bank, amounted to over $240 million in 2004.

Tax revenue, which levelled off at 6.9 per cent of GDP in 2003, putting the government's budget under strong pressure, is estimated to have increased to 7.9 per cent in 2004, owing to collection efforts directed at major taxpayers and the customs service. The government hopes to introduce a value added tax by 2006-07.

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)
Total revenues and grants[a]	**11.3**	**6.6**	**8.5**	**9.8**	**12.7**
Tax revenue	4.8	4.1	6.7	6.9	7.9
Grants	5.9	0.0	0.4	2.0	3.6
Total expenditure and net lending[a]	**11.6**	**8.3**	**10.5**	**13.7**	**17.5**
Current expenditure	9.7	8.2	9.5	11.0	11.3
Excluding interest	*9.4*	*6.8*	*6.3*	*7.5*	*6.2*
Wages and salaries	0.7	1.7	2.1	2.5	2.6
Interest	0.3	1.4	3.2	3.5	5.1
Capital expenditure	0.5	0.1	0.6	2.7	5.1
Primary balance	**0.0**	**-0.3**	**1.2**	**-0.4**	**0.3**
Overall balance	**-0.3**	**-1.7**	**-2.1**	**-3.9**	**-4.8**

a. Only major items are reported.
Source: IMF data; estimates (e) based on authors' calculations.

The rise in budget expenditure – from 10.5 per cent of GDP in 2002 to 13.7 per cent in 2003 and 17.5 per cent in 2004 – is mainly due to the creation of political transition structures and the cost of peacekeeping. The 2004 budget act, for example, includes $300 million for the Disarmament, Demobilisation and Reintegration (DDR) programme and preparations for the elections. Under the circumstances, the state has had to control its other expenditures, particularly general costs like fuel, and reduce wastage. In particular, subsidies and exemptions for oil products have been abolished. Increases in world oil prices are now passed on to pump prices and, by an automatic mechanism, to public transport prices. As a result, the price of a litre of petrol rose from 310 Congolese francs (CF) in April 2004 to 350 CF in October 2004 and the fare for public transport in Kinshasa from 80 to 100 CF in October 2004. Accumulated arrears, most of which date from before 1997, remain a major problem. Some civil servants have not been paid for years.

At present, spending on health, education and basic economic infrastructure depends exclusively on external financing. To address the country's enormous infrastructure needs, public investment should rise from 2.7 per cent of GDP in 2003 to 10 per cent in 2005, with funding expected from the international community under the Emergency Multisector Rehabilitation and Reconstruction Programme (EMRRP).

Monetisation of the public deficit, which was pushing inflation to very high levels, was largely brought under control in 2002. At the same time, the Central Bank of Congo (BCC) was given new statutes establishing its independence in the conduct of monetary policy (although its senior managers are appointed by the President) and limiting advances to the Treasury. Inflation, which hit a peak of nearly 900 per cent in the 1990s and stood at 357 per cent in 2001, was brought down from an average of 25.3 per cent in 2002 to 12.8 per cent in 2003 and 8.5 per cent in 2004. The 2004 target of 6 per cent was not achieved, as the authorities' recourse to bank financing went over forecast because of tensions over public spending.

With inflation under control, the BCC was able progressively to reduce its discount rate, from 27 per cent in 2002 to 6 per cent in the first half of 2004, but inflationary pressures pushed it back up to 14 per cent in August 2004. Manipulation of interest rates is not an effective means of regulating the money supply, however, as the banking system plays only a small role in the economy and does not function well. In addition, the BCC faces a sharp increase in demand for cash, notably because, in a largely "dollarised" economy, confidence in the national currency has been to some extent restored. Businesses conduct all their transactions in cash, despite the lack of large-denomination banknotes. There are plans to introduce new 1 000, 20 000 and 50 000 CF banknotes.

The credibility of the banks has been deeply shaken by bankruptcies and the lack of liquidity. There are very few bank accounts in the country (about 35 000). The geographical coverage of the banking system is in general very poor, with only one bank branch for every 2.4 million inhabitants and only ten commercial banks, which conduct the bulk of their business in Kinshasa. The activities of the banking sector are limited to financing trade and foreign exchange transactions. Credit amounted to less than 1 per cent of GDP in 2003. Loans are generally granted in dollars for a period not exceeding six months. There are few transactions on the inter-bank market, although the BCC has been issuing Treasury notes since late 2002. The banking system has undergone a major restructuring, recapitalisation and liquidation programme. In 2004, nine banks were put into liquidation, including three public sector establishments, and seven are being restructured. There have been some encouraging signs in the sector, however, with the arrival of foreign investors such as Citibank, Stanbic and Rawbank.

After a period of sharp depreciation, the Congolese franc levelled off in 2003. The dollar, which stood in January 1999 at 2.40 CF, was worth 180 times more in July 2003 at 432 CF. Since then, exchange rate fluctuations have been relatively moderate. The Congolese franc gained slightly in value, then depreciated again in the third quarter of 2004 and the first quarter of 2005. The exchange rate has been completely free-floating since the elimination of the last restrictions in February 2003. The multiple exchange rate system has been abolished and the black market, where the dollar was traded at a premium of 182 per cent in May 2001, has virtually disappeared.

External Position

Trade liberalisation, launched in 2001, has brought a reduction in customs tariffs. DRC is participating in the liberalisation efforts of several regional economic organisations, including the Economic Community of Central African States (ECCAS), the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC). It also enjoys preferential trade terms with the United States under the African Growth and Opportunity Act (AGOA) and with the European Union under the Everything But Arms initiative. In addition, the government has initiated a reform of the customs service and set up a one-stop reception point at the port of Matadi to streamline customs formalities and allow better control of government fiscal revenue.

Exports fell from $1.5 billion in 1996 to around $800 million in 1999. Although some growth has been recorded since 2000 ($1.3 billion in 2003), they have not yet returned to the levels of the 1990s. Their share in GDP, however, increased from 13.3 per cent in 2001 to 27 per cent in 2004. The diamond sector continues to account for the bulk of exports. Non-industrial production has increased, mainly as a result of the introduction of the Kimberley Process for certification of the origin of mineral substances.

At the same time, the share of imports in GDP jumped from 12 per cent in 2001 to 27.4 per cent in 2004, reflecting the resumption of investment in infrastructure and the installation of the GSM network. This rise resulted in a trade deficit of over 0.4 per cent of GDP in 2004.

New investment totalling $2.4 billion was approved in 2003 and 2004. The target sectors were services, the food industry, construction and natural resources. The biggest operations include the cell phone project of the South African firm Vodacom (an investment of $94 million) and the Congo Korea Telecom project for the installation of telecommunications infrastructure ($1.6 billion). Actual disbursements are much lower, however. In 2003, foreign investment inflow stood at $132 million and accounted for 23.6 per cent of gross fixed capital formation.

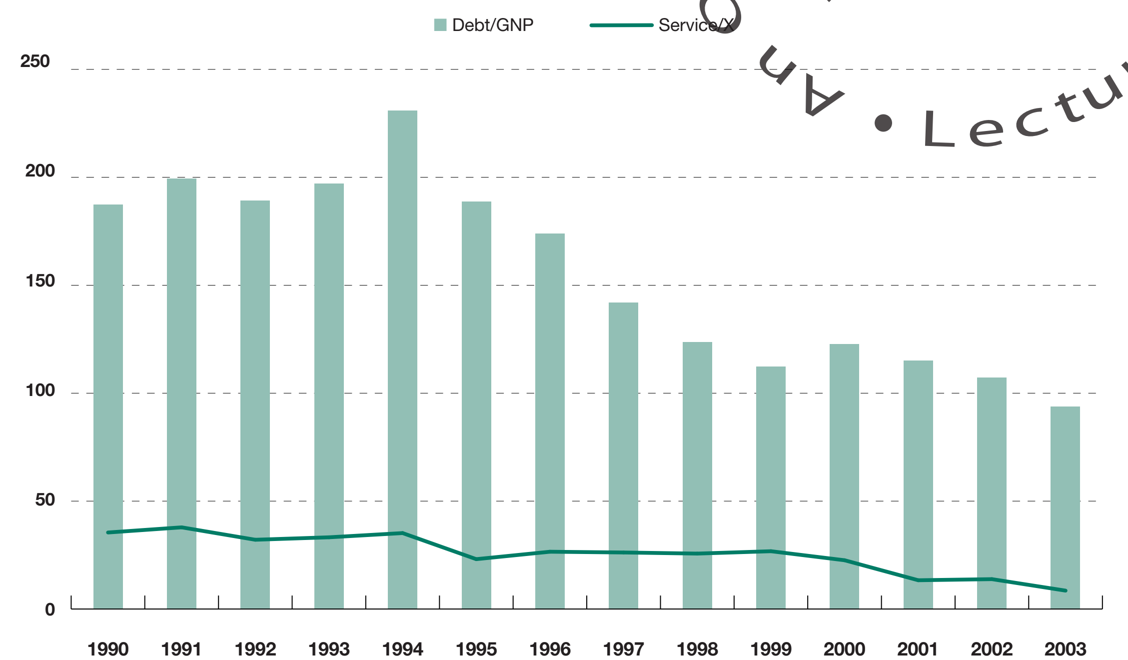
Official development assistance has gradually resumed since 1999, and the support of the international financial community is one of the keys to economic recovery. The IMF granted a $750 million loan as part of the poverty reduction and growth facility (PRGF) for the 2002-05 period and the World Bank a $450 million economic recovery credit (ERC). Tranches of $214 million and $200 million were approved in

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)
Trade balance	14.0	1.4	0.9	0.2	-0.4
Exports of goods (f.o.b.)	30.0	13.3	20.3	23.0	27.0
Imports of goods (f.o.b.)	-16.0	-12.0	-19.3	-22.8	-27.4

Source: IMF data; estimates (e) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

September 2003 and February 2004. In 2004, external aid exceeded $1 billion, two-thirds of which came from multilateral institutions. At a meeting of the consultative committee in November 2004, the development partners made funding commitments totalling $5.7 billion in 2005. Experience in other countries has shown that, in post-conflict situations, aid must bring immediate, visible results if it is to have an impact on political stability. For this reason, the government and donors attach particular importance to the quality of expenditure and smooth, rapid disbursement.

External debt is very high at $12.6 billion, nearly 200 per cent of GDP. As for bilateral debt, DRC signed a restructuring agreement with the Paris Club in September 2002 and obtained a 67 per cent reduction in debt service. Subsequently, under the Heavily Indebted Poor Countries (HIPC) Initiative, the reduction was increased to 90 per cent, representing $100 million in 2003, $200 million in 2004 and $200 to $400 million per year from 2005 on. Several countries have signalled their readiness to cancel debt once the country has reached completion point and even, in the case of Switzerland, immediately. The debt service/exports ratio fell from 8.9 per cent in 2003 to 5.8 per cent in 2004, but should rise to about 10 per cent during the 2005-07 period owing to further borrowing.

Structural Issues

The business climate in DRC has paid the price of the long period of political instability. The private sector in general is suffering from a lack of infrastructure, a lack of judicial and economic security, public sector inefficiency and corruption, the size of the public debt, high energy costs and often unfair competition from illegal imports.

The infrastructure problem, particularly in the transport sector, has taken on overriding importance in DRC because it is the pre-condition for any possibility of a return to normality. DRC has 57 700 km of roads, but only 2 800 km are paved and much of the road network is in poor condition owing to lack of maintenance. Even before the war, there was virtually no river traffic on the Congo and its tributaries because of the risk that travellers and goods would be held for ransom. The virtual closure of the river to traffic has cut Kinshasa off from the northwestern, northeastern and northern regions, which were important contributors to the capital's food supply. Port facilities are inadequate and there is no deep-water port. For the eastern and southern regions, which are completely landlocked, sea traffic passes through the ports of Dar-es-Salaam in Tanzania and Lobito in Angola. The EMRRP is to carry out major construction projects in the transport, water, water treatment and electrical energy sectors in urban areas. The estimated cost of the EMRRP in 2002 was $1.7 billion, but it will probably increase since the programme is to be extended to areas formerly held by the rebels.

To make the country's industrial sector more competitive, the government has launched a programme to reform public enterprises, under the aegis of the steering committee for reform of public enterprises (COPIREP). The reform targets the mining, transport, energy, telecommunications and financial sectors in particular. Public mining, energy, water and transport enterprises are the dominant forces in the production system, but the state is heavily indebted and unable to assume its role of promoting economic activity. The current period of political transition is, however, not propitious for the privatisation of public sector companies, as there is opposition to the "squandering of national assets". The country has adopted new investment, mining and forestry codes that afford operators and investors more fiscal incentives, guarantees and transparency. A new employment code was also published in October 2002 in an effort to align working conditions with international standards. The national investment promotion agency (ANAPI), established in 2001, serves as a one-stop reception point for investors seeking to set up a business in the country. Recently, DRC expressed its intention to join the Organisation for the Harmonisation of Business Law in Africa (OHADA) in order to modernise its judicial system.

The government has also committed itself to improving the quality of public services, reforming the civil service and establishing a structure to fight corruption. An ethics and anti-corruption commission has been in existence since mid-2003 but had finished only two cases as of October 2004, with 87 still in progress. Parliament has passed a law against money laundering. The government has approved a first wave of 10 000 early retirements in public services, but the reform programme provides for 100 000 in all. Gécamines is also being restructured, and its workforce reduction programme provides for the early retirement of 10 000 employees.

To improve public sector governance, it will be necessary to solve the problem posed by the failure to pay the salaries of lower-grade civil servants, which is the cause of their lack of motivation and the corruption in the civil service. A recent financial audit revived the scandal on this subject by revealing that certain senior managers in public enterprises had monthly earnings of up to $25 000, whereas the minimum wage in the civil service is $15. Salaries are higher in the private sector at around $50 per month, but employees are often not paid for several months at a time.

Small and medium-sized enterprises (SMEs) and micro-enterprises have an important role to play in rebuilding the country because they are flexible, adapt easily to demand and can be effective in the fight against poverty. Most small Congolese companies went bankrupt in the 1990s, either following the looting which occurred from 1993 to 1996 or during the war period. Major obstacles to the development of small firms include their lack of technical and managerial skills, difficult access to financial resources and, most importantly, lack of security. There is very little demand for sub-contracting on the part of large firms. As a result, SMEs are hardly participating at all in the development process. Their technology is obsolete and their productivity very low. They have neither accounting systems nor any real financial and organisational discipline, and their average lifetime is five years. In addition, the steady decline in living standards has led to explosive growth of the informal productive sector, reflecting household survival strategies. Small businesses and families often overlap, and the Congolese are often self-employed or employ members of their families. The bulk of the income from their activities is devoted to household consumption rather than to investment and business growth. The authorities estimate that 40 per cent of businesses in urban areas have no permit, and the figure is certainly much higher in rural areas.

The procedures required for starting a business are costly in terms of both time and money. On average, it takes five months to start a business in RDC, there are 21 separate procedures – some established by legislation dating from the early 20th century – and the cost is estimated at 603 per cent of national income per capita. In addition, companies complain of red tape and the opportunistic behaviour of tax officials, who tirelessly seek to profit from the system. The two problems most often mentioned are the large number of taxes and the fact that tax assessments are based not on net income but on turnover.

The biggest obstacle facing SMEs is financing. They cover their capital requirements through advances from customers, family and friends. Tontines are very little developed in comparison with Cameroon and other countries in the region. Banks grant no loans whatsoever to SMEs. An SME department has been formed within the Ministry of Industry, but its financial resources are paltry given the scale of the sector's requirements. With less than $1 million per month, the fund for the promotion of industry can support no more than five or six projects per month, and it prefers to assist large companies located in the two provinces closest to the capital, Kinshasa and Bas-Congo.

The micro-credit sector is also under-developed. As is generally the case, savings and credit co-operatives replaced banks in this activity in the 1970s, and NGOs subsequently played a significant role in financing micro-business. The crisis and the hyper-inflation of the 1990s had a strong impact on the way they operate. NGOs are now forbidden to conduct financing operations. In September 2000, a micro-financing unit was set up in the BCC's department for the supervision of financial intermediaries, with the basic role of supervising the sector. This unit wants to restructure the sector and eliminate all informal and inefficient forms of micro-financing via an accreditation system. Micro-finance institutions are often very inefficient. The savings, credit and investment co-operative for SMEs (CECI-PME), for example, collects the savings of members for redistribution to them in the form of loans, on condition that they have subscribed for three months and have participated in a training programme. It subsequently requires financial guarantees and funds covering 30 per cent of the cost of the investment to grant a six- or twelve-month loan at a monthly interest rate of 5 per cent. The average loan is $2 700. In September 2004, a number of donors took part in the launch of the Pro Credit Bank, which specialises in micro-financing. This bank, which operates in several countries, is supported by Dutch and German financial partners, the International Finance Corporation and a technical partner. It offers financial services only to small and micro-enterprises.

Political and Social Context

Since the signing of the Lusaka ceasefire agreement with Rwanda and Uganda in July 1999, a number of important steps have been taken towards the restoration of peace and reunification of the country. The global and all-inclusive transition agreement signed in Pretoria in December 2002 paved the way for the new constitution and the transition institutions. Various bodies intended to ensure a sound democratic process have been set up: the ethics and anti-corruption commission, a high authority for the media, a human rights commission, a commission for truth and reconstruction, and an electoral commission. The government of national reunification formed in July 2003 brings together the various political and military forces in presence, with a president and four vice-presidents belonging to four distinct military entities. Although power sharing has made it possible to re-establish calm, it can also slow down decision-making. The DDR process has also got under way, although not without difficulty. The demobilisation period will last for 18 months and will be followed by a three-year reintegration period. The number of combatants who took part in the conflict is estimated at 150 000 to 200 000.

The transition process is clashing with the economic and social interests of the neighbouring countries – Burundi, Uganda and Rwanda – involved in the conflict in the eastern DRC. Illegal mining and smuggling of natural resources such as diamonds helped to finance the war. In addition, internal conflicts in neighbouring countries remain an indirect destabilising factor in DRC. Political stabilisation of the entire Great Lakes region is therefore essential to economic development and the establishment of peace in DRC. In October 2004, nearly 6 000 UN soldiers and extra police were deployed to stabilise the situation in the east, in Ituri, Nord-Kivu and Sud-Kivu. Provincial authorities in the north and east, which were long in rebel hands, were appointed only in June 2004. Free democratic elections were scheduled for June 2005 by the independent electoral commission, but in the end were postponed. It would be easier to hold proper elections if these problems were settled, particularly the reunification of the police and national army.

DRC is one of the poorest countries in the world, with strongly marked inequalities. The conflict has had a devastating impact on productive capacity, on the environment and on poverty. Human rights violations, particularly against women and children, have deeply affected the population. In several provinces, anti-personnel mines still prevent people from cultivating the land. In 2002, 80 per cent of the population lived under the poverty line of $0.2 per day. Nearly 44 per cent of women and about 22 per cent of men have no income. Regional disparities are very marked. For example, average annual income in the eastern part of the country was $32 per capita, as against $138 in the south and $323 in Kinshasa province. The country's poverty is reflected in the malnutrition affecting 30-50 per cent of women and children. Altogether, 16 million people are in a situation of food insecurity. A number of vulnerable groups lacking care and food – refugees, orphans, children out of school and child soldiers – have come into being.

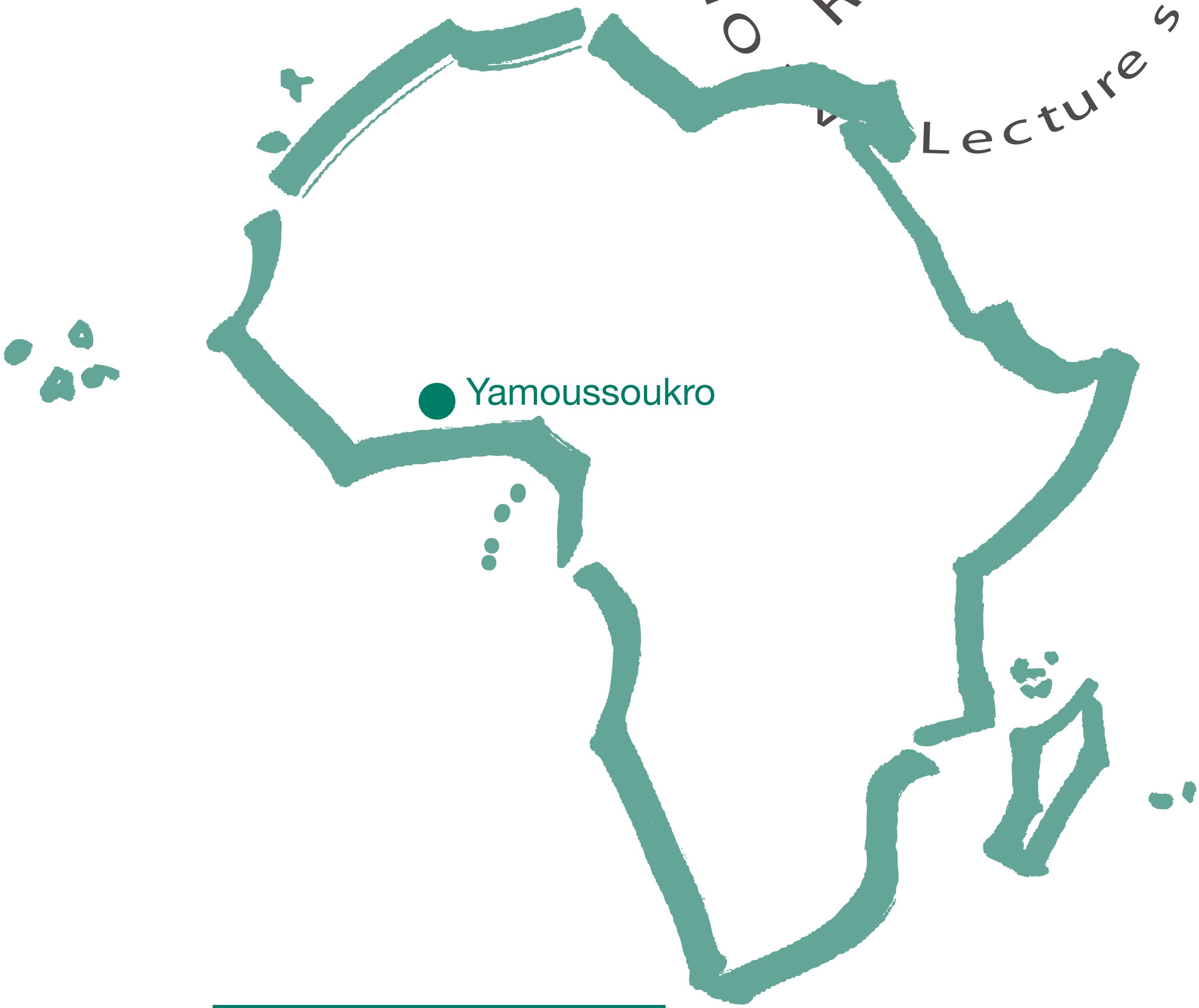
The employment crisis is one of the major causes of the social crisis. The unemployment rate is very high, while salaries and social benefits are trifling. In 2000, only 4 per cent of the total working population, and 8 per cent of the male working population, had a job. Married women cannot enter the job market without their husbands' permission. The informal sector has become the largest sector of the economy, and salaries are negotiated in a context of strong demand for employment.

Less than half of urban water requirements are satisfied, while in rural areas, where two-thirds of the population live, access to drinking water is virtually non-existent. Social indicators in general have reached alarming levels and have deteriorated these last few years. The infant mortality rate has risen from 125 per thousand in 1990 to 170 per thousand in 2000, the maternal mortality rate from 800 per 100 000 live births in 1990 to 2 000 at present. Life expectancy was 42 years in 2002, whereas the African average is 51.

Nearly half the population is under 15 years old, a situation which creates enormous needs in terms of education and health for young people. Unfortunately, fewer than 26 per cent have access to basic health care. Malaria causes heavy losses in DRC, and diseases which had been eradicated, such as trypanosomiasis, leprosy and plague, have reappeared. The HIV/AIDS pandemic affects 4 per cent of the population aged 15 to 49, and the figure could be as high as 20 to 22 per cent in occupied provinces in the east. According to the latest estimates, about 750 000 children have lost at least one parent to the disease.

Owing to the incapacity of the state, the education system is primarily financed by parents. The school enrolment rate is 52 per cent, and illiteracy, already very high among the general population at 37 per cent, reaches 48 per cent among women. Enrolments in primary education have fallen because of the isolation of some areas, parents' increasing inability to pay school fees, the failure to maintain infrastructure, lack of schoolbooks and a decline in teaching quality. Primary school teachers are paid less than $20 per month. The national programme calls for universal primary education by 2015, but this objective, unfortunately, does not seem credible.

Côte d'Ivoire



key figures

- Land area, thousands of km² 322
- Population, thousands (2004) 16 897
- GDP per capita, $ (2003) 845
- Life expectancy (2000-2005) 41.0
- Illiteracy rate (2004) 47.3

CÔTE D'IVOIRE, LONG A MODEL OF STABILITY, with an open economy, social redistribution and ethnic peace, has been torn by a political crisis since a failed coup in September 2002 that split the country into two parts. Lawlessness worsened in 2004 and further violence occurred, notably in March, after the government banned opposition demonstrations, and in November, when clashes with French forces resulted in many civilian casualties (57 dead and over 2 000 wounded). Some 7 000 French citizens were evacuated to France. This caused an economic slump at the end of the year, with many jobs lost and serious revenue shortfalls for the government.

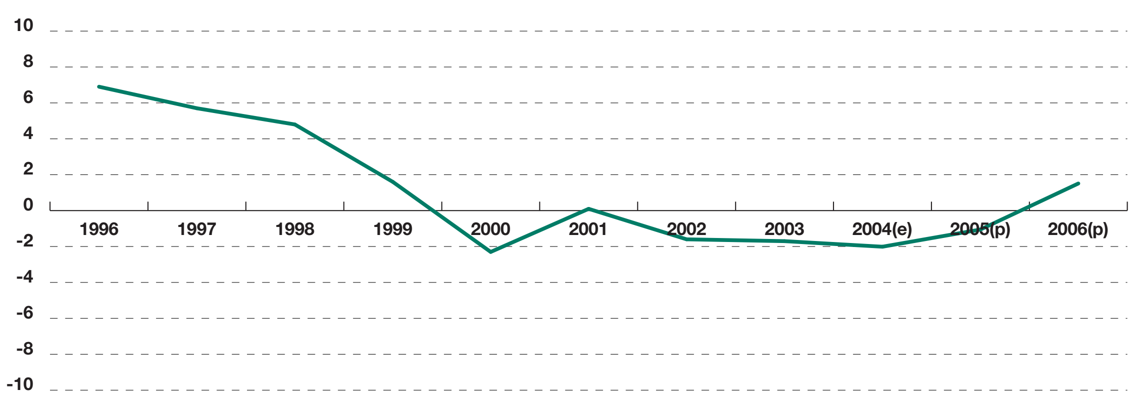
Economic and financial programmes with development partners have been suspended. World Bank disbursements were halted in June 2004 after the government stopped debt repayments, and the country received no external budget aid in 2004.

Repeated delays and postponements in the disarmament, demobilisation and reintegration (DDR) programme and in national reconstruction continue to affect all economic and social indicators. The growth estimate for 2004 has been revised downwards, and the economy was in recession for the third year running. The only remaining economic pillar is cocoa, since all other sectors have been severely hit by the crisis.

A worsening security situation has sent the economy plunging back into recession.

Social indicators have significantly worsened. The ongoing crisis, violence and abuses are still forcing the inhabitants of the rebel-held north of the country to flee to the south, while other Ivorians are leaving the country altogether. Emergency situations have proliferated, with worsening humanitarian crises in the west, centre and north of the country.

Figure 1 - **Real GDP Growth**



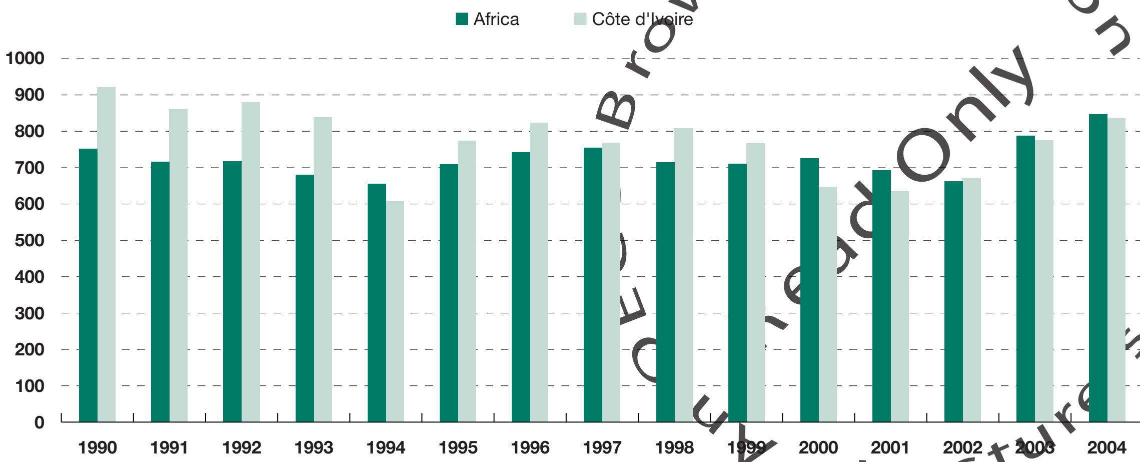
Source: BCEAO and IMF data; estimates (e) and projections (p) based on authors' calculations.

Political stability and national reconciliation are essential for economic recovery. The success of the elections scheduled for 2005 will be a key test, but the delays and damage caused by years of civil war will continue to plague the country.

Recent Economic Developments

Strong economic growth stopped after the 1999 coup, and in 2000 the economy fell into recession,

Figure 2 - **GDP Per Capita in Côte d'Ivoire and in Africa** (current $)



Source: IMF.

shrinking by 2.3 per cent. Stabilisation efforts, resumption of budget aid under a new IMF programme in 2001 and adoption of an interim poverty reduction strategy paper (PRSP) in April 2002 began a recovery that was cut short by a further political crisis in September 2002. The virtually zero growth in 2001 was followed by a return to negative growth in 2002 (-1.6 per cent) and in 2003 (-1.7 per cent). The events of March 2004 and three days of looting in November 2004 damaged all economic sectors, and the GDP growth rate in 2004 was again negative (-2 per cent). Taking population growth into account, real per capita GDP fell 5.2 per cent in 2004. In 2005, real GDP is projected to fall by 1.1 per cent owing to the consequences of the crisis, particularly the departure of businesses from the country. It may be positive again in 2006 (+1.5 per cent), but this projection assumes a return to political peace.

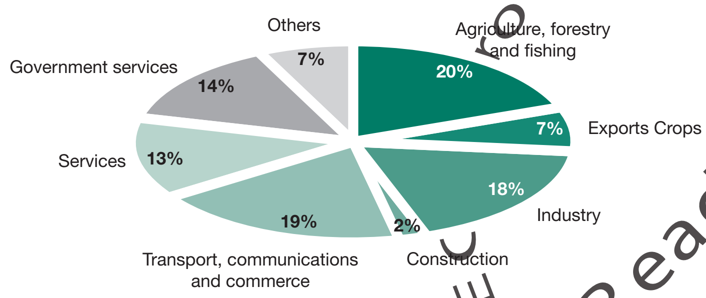
The Ivorian economy is traditionally dominated by agriculture, which may be divided into export crops (mainly cocoa and coffee) and food crops such as maize, rice, sorghum and groundnuts. Farming's contribution to GDP rose in 2004, largely because value added fell in other sectors.

The coffee and cocoa sector brought in about 40 per cent of export revenue in 2004, had 600 000 growers and provided jobs for many immigrant workers. Despite reforms backed by development partners, the sector still has major institutional weaknesses. Farmers complain that producer prices are too low, and co-operatives are still badly run. The coffee and cocoa exchange (BCC) set the cocoa price at 390 CFA francs/kg for the 2004/05 season, whereas the farmers' unions demanded at least 500 CFA francs. A strike by farmers at the start of the season, in October 2004, and the political crisis the following month pushed up cocoa prices on the New York market, where they reached $1 810 a tonne (990 CFA francs/kg) on 9 November, the highest price since May 2003, before dropping back to around $1 600 (875 CFA francs/kg) at the end of November.

Cocoa and coffee provide substantial revenue for the government via an export tax on these products. The levy of 220 CFA francs/kg for cocoa is estimated to have raised about 258.5 billion CFA francs in 2004. International organisations have called for total cocoa taxes to be capped at no more than 30 per cent of the export price so that farmers can get a better return.

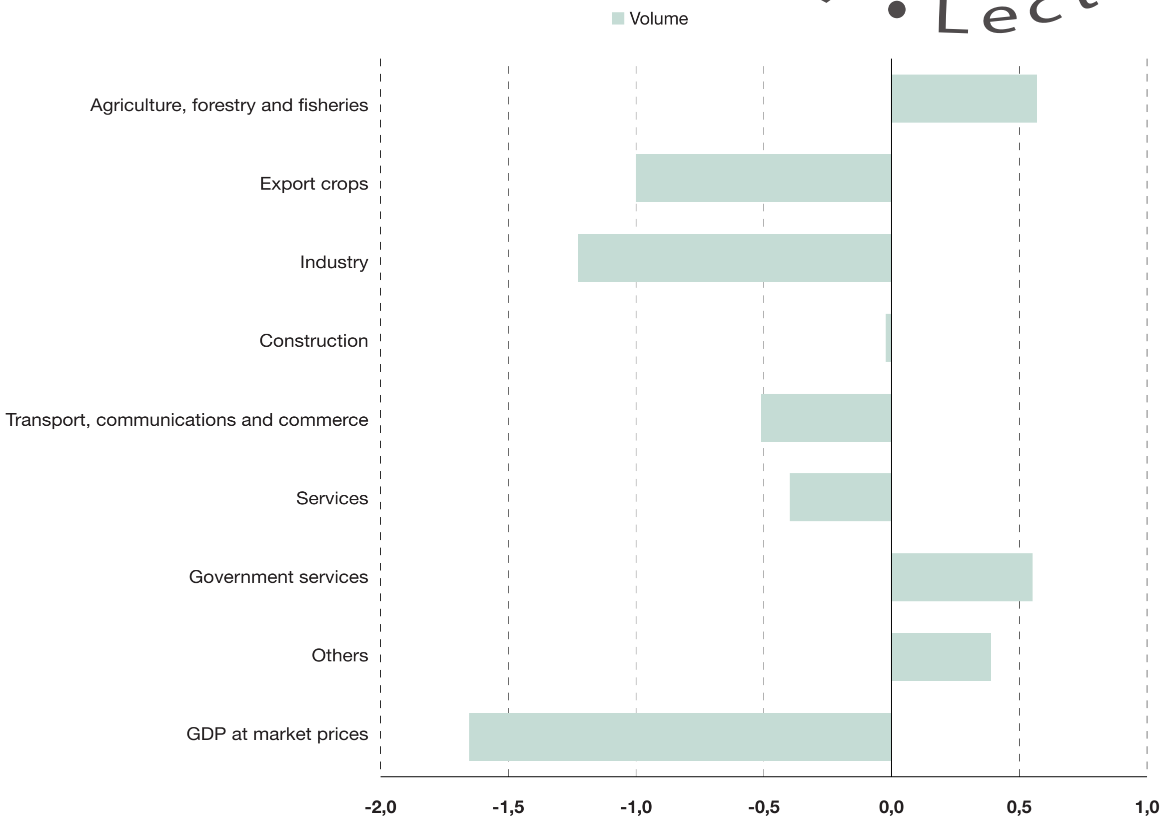
Despite its troubles, Côte d'Ivoire was still the world's biggest cocoa producer in 2004, ahead of Ghana and Indonesia, as the harvest was already in when violence erupted in early November. Most of the cocoa crop was exported without difficulty except during the disturbances, when ship owners did not risk sending their vessels near the country's coast. The official figure for 2004 production was 1.45 million tonnes (45 per

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on Ministry of Economy and Finance data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on Ministry of Economy and Finance data.

cent of the world market of 3.1 million tonnes), but the authorities complained that some cocoa was being smuggled into neighbouring countries, probably Ghana, where prices to the farmer were better.

Côte d'Ivoire also produces cotton (142 700 tonnes in 2004), palm oil (254 000 tonnes in 2004), rubber and fruit. Output of all was steady in 2004 year-on-year, although it was affected by the drop in world prices and the fact that most of it was grown in the rebel-held north, meaning that distribution and marketing channels were disrupted. Some of the cotton and cashew harvest passed through the country's northern neighbours, Burkina Faso and Mali.

Food crop production grew in step with the population, about 3 per cent in 2004. New varieties of cassava and yams, with triple the yield of traditional ones, are available from the national agronomic research centre and could boost production in coming years.

The mining sector expanded strongly (29 per cent) in 2004 owing to production from new oil deposits. Daily oil output is nearly 20 000 barrels but may soon reach 50 000 as new fields come on stream. The three offshore fields alone would make the country self-sufficient for the next decade. Proven reserves are 100 million barrels of oil and 1 100 billion cubic metres of natural gas.

Côte d'Ivoire also has reserves of gold, iron (1.5 billion tonnes), nickel (439 million) and manganese (35 million). The closure of the Angovia mine in the central part of the country has sharply reduced gold output, from 3 500 kg in 2002 to 1 300 kg in 2003. Diamond production is also thought to have fallen considerably in 2003 and 2004. The crisis has unfortunately brought looting of natural resources such as timber and minerals that is hard to quantify.

The manufacturing sector is well-diversified, and the agro-food industry has traditionally benefited from the government's insistence that items such as coffee, sugar, cotton, milk, tobacco and beverages be processed in Côte d'Ivoire. The sector has been badly hit by the crisis, however, and in the first nine months of 2004 grew only 1 per cent, compared with drops of 10.5 per cent in 2003 and 5.8 per cent in 2002. The November 2004 riots in Abidjan destroyed 81 businesses, a major blow for the sector.

In the services sector, tourism has collapsed and trade has become mostly informal as an extensive parallel economy has developed in the rebel-held areas.

On the demand side, overall investment fell from 9.6 per cent of GDP in 2003 to 8.5 per cent in 2004 because of tighter budgeting and because the government does not control all of the country. The recent rise in Côte d'Ivoire's country risk rating will also discourage private investment, both local and foreign. Investment is expected to fall further in 2005 and 2006, to about 6.6 per cent of GDP.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**9.6**	**10.9**	**8.9**	**9.6**	**8.5**	**6.6**	**6.6**
Public	3.7	1.7	2.4	2.3	2.1	1.8	1.8
Private	5.9	9.2	6.6	7.3	6.4	4.8	4.7
Consumption	**81.1**	**80.6**	**71.4**	**75.6**	**78.2**	**79.3**	**78.6**
Public	16.0	13.7	15.6	15.4	17.1	18.2	18.7
Private	65.1	66.9	55.8	60.2	61.0	61.0	59.9
External sector	**9.3**	**8.5**	**19.7**	**14.9**	**13.3**	**14.1**	**14.8**
Exports	41.0	40.2	46.1	42.8	41.9	42.5	42.6
Imports	-31.7	-31.7	-26.4	-27.9	-28.5	-28.4	-27.8

Source: Ministry of Economy and Finance data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Public finances have deteriorated since 2002 because of the continuing political crisis, and budget deficits have mainly been funded by mounting domestic and external debt. Government liquidity problems have thus been frequent in recent months. The balance of payments also took an unfavourable turn in 2004 as cocoa exports fell and new foreign capital dwindled. Côte d'Ivoire did not comply with any of the convergence criteria of the West African Economic and Monetary Union (WAEMU/UEMOA) in 2004.

Fiscal and Monetary Policy

The budget situation has been worsening since 2002. Despite good tax collection and expenditure cuts to offset the lack of foreign funding, the budget deficit, which was 1.5 per cent of GDP in 2002, swelled to 2.9 per cent in 2003 and 3.9 per cent in 2004. To fund the deficit, government debt to the banking system rose from 31 billion CFA francs in 2003 to 47 billion in the first nine months of 2004. The authorities also sought to borrow on the financial market by issuing Treasury bills and other debt instruments, but managed to raise only 62.5 billion CFA francs of a hoped-for 85 billion in 2004. In the end, the government continued to accumulate domestic and external arrears, and the budget deficit is expected to be 4.7 per cent of GDP in 2005 and 5.3 per cent in 2006.

Tax collection was remarkably good considering that the various exemptions granted to firms cut into revenue and that non-tax revenue, payments by companies and privatisation proceeds all declined. Tax revenue will be hit in 2005 by the closing of many French firms in November 2004.

The increased spending called for in the 2004 budget was aimed at helping the country emerge from the crisis and restore public services, especially health and education. But without budget aid, investment spending had to be cut. The government launched major projects such as free education, universal health care, a fund to boost youth employment and enhanced security. The employment fund was set up in 2004 with 10 million CFA francs in guarantee funds, but the health insurance scheme is still being drafted. The security forces have expressed their grievances by throwing up street barricades that hinder traffic.

Budget cuts mainly affected investment, which should further contract in 2005. Only the wage bill increased significantly, from 6.6 to 7.1 per cent of GDP between 2003 and 2004, due to a pay-scale revision and substantial hiring in the police and military forces.

The Central Bank of West African States (BCEAO) keeps the CFA franc pegged to the euro and tries to control inflation in the region. Money market interest rates have been steady for several years, at 4.95 per cent, but discount rates and the inter-bank rate have fallen slightly, with the latter down from 5.5 per cent in December 2003 to 4.88 per cent in September 2004.

Banks in the rebel-held areas are closed and people have to travel to government-controlled areas or neighbouring countries to get cash. They can also use various facilities set up to cope with the problem. The BCEAO introduced new banknotes in its eight member states in mid-September 2004. The regional stock exchange (BRVM), set up in 1998 to serve all WAEMU members, has been badly hit by the crisis and its activity has slowed.

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**20.6**	**17.5**	**18.0**	**16.9**	**17.3**	**17.3**	**17.2**
Tax revenue	16.8	14.8	15.5	14.6	14.9	14.8	14.5
Grants	0.7	0.5	0.5	0.3	0.5	0.5	0.7
Total expenditure and net lending[a]	**22.4**	**16.6**	**19.5**	**19.7**	**21.3**	**22.0**	**22.5**
Current expenditure	17.5	14.7	16.2	17.0	18.7	19.8	20.3
Excluding interest	*12.3*	*11.4*	*13.0*	*14.3*	*16.0*	*17.1*	*17.6*
Wages and salaries	6.3	6.2	6.4	6.6	7.1	7.3	7.3
Interest	5.2	3.3	3.3	2.7	2.8	2.8	2.7
Capital expenditure	4.9	1.8	3.2	2.6	2.4	2.1	2.1
Primary balance	**3.4**	**4.2**	**1.8**	**-0.2**	**-1.1**	**-1.9**	**-2.6**
Overall balance	**-1.8**	**0.9**	**-1.5**	**-2.9**	**-3.9**	**-4.7**	**-5.3**

a. Only major items are reported.
Source: BCEAO data; estimates (e) and projections (p) based on authors' calculations.

Inflation is under control but prices vary greatly between the north, rural areas and Abidjan. Despite higher pump prices for petrol and price hikes for bread and transport, inflation fell from 3.5 per cent in 2003 to 1.9 per cent in 2004 and should stay very low, at around 1.5 per cent, in 2005 and 2006.

External Position

Côte d'Ivoire signed the Cotonou Agreement in June 2000 for a 20-year period, giving it preferential relations with its main trading partner, the European Union, for official development aid as well as trade. The country was also accepted in December 2003 as a beneficiary of the US African Growth and Opportunity Act (AGOA), which gave it preferential access to the US market for textile and clothing exports, but a year later, on 22 December 2004, it was withdrawn from the list of beneficiary countries with no reason given.

Côte d'Ivoire belongs to the Economic Community of West African States (ECOWAS) and WAEMU, whose members have had a common external tariff since January 2000. Despite its relatively advanced infrastructure and manufacturing sector, the country has benefited very little from membership of these regional bodies since the political crisis split it in two. Its neighbours were badly hit by the Ivorian upheaval in 2002, owing in particular to transport problems, but recovered in 2003 and 2004. If these problems persist, however, they may slow sub-regional growth and integration.

Côte d'Ivoire depends heavily on its agricultural exports. Cocoa accounts for a third of total exports, with coffee, cotton, wood and oil also important. The country has a structural trade surplus and exports have amounted to more than 40 per cent of GDP since 2002.

The surplus has fallen since 2002, however, from 21.8 per cent of GDP to 18.2 per cent in 2003 and

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	12.6	13.7	21.8	18.2	16.5	17.1	17.7
Exports of goods (f.o.b.)	35.5	35.2	42.8	41.2	40.2	40.8	40.8
Imports of goods (f.o.b.)	-22.9	-21.5	-21.0	-23.0	-23.7	-23.6	-23.1
Services	-7.2	-6.4	-8.2	-7.3			
Factor income	-6.4	-5.5	-5.4	-4.9			
Current transfers	-2.8	-2.9	-4.0	-3.4			
Current account balance	**-3.9**	**-1.1**	**6.6**	**2.5**			

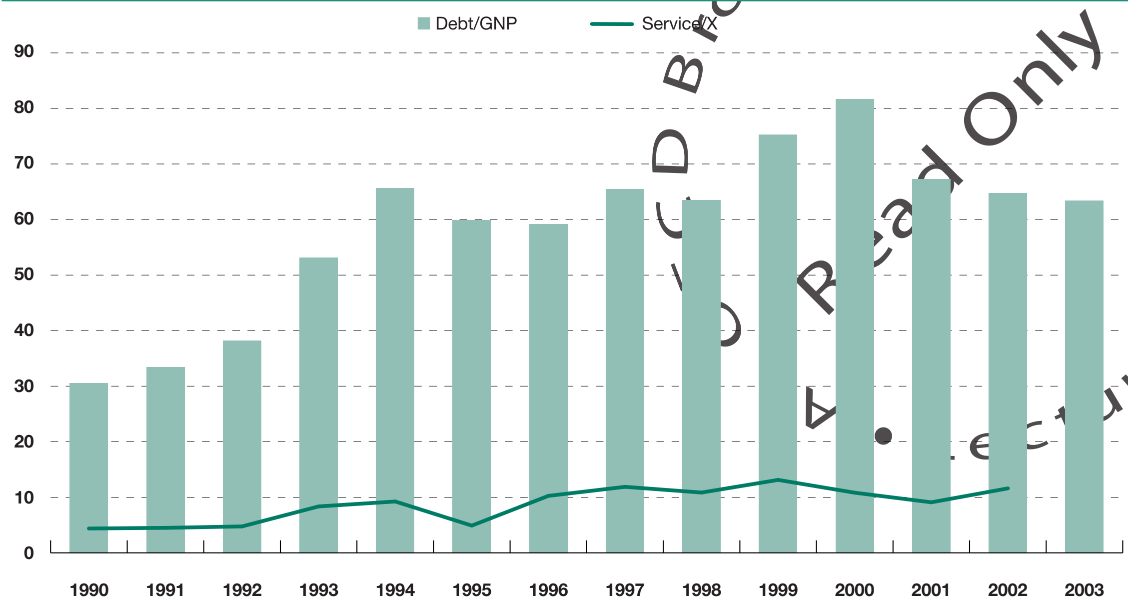
Source: BCEAO data; estimates (e) and projections (p) based on authors' calculations.

16.5 per cent in 2004. Exports declined 7.7 per cent in 2003 year-on-year in volume terms, as all components performed poorly except for crude oil (+56.4 per cent), cotton (+5 per cent) and rubber (+4 per cent). It was mainly the decline in exports of processed coffee and fresh pineapples that drove the share of exports in GDP lower in 2004. Imports have fallen in volume terms over the past three years and should continue to drop in 2005 and 2006, when they are expected to amount to 17.1 and 17.7 per cent of GDP respectively.

The government stopped servicing its debts to the World Bank in 2004, and Côte d'Ivoire was classed in June as a bad-debt country. This could complicate implementation of the peace agreement, since it was to be substantially funded by the Bank. Arrears due to the World Bank's subsidiary, the International Bank for Reconstruction and Development (IBRD), reached $64.2 million in September 2004 and those to another, the International Development Association (IDA), $16.7 million.

Côte d'Ivoire has also been in arrears since February 2003 to the African Development Bank (ADB) and now owes it about $253 million. The country's external arrears topped $524 million at the end of December

Figure 5 - Stock of Total External Debt (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

2004. It has not reached decision point under the Heavily Indebted Poor Countries (HIPC) Initiative. External debt was 70.3 per cent of GDP in 2004, and debt service amounted to 17.5 per cent of the value of the country's total exports.

Structural Issues

One of Côte d'Ivoire's big advantages was its extensive, well-maintained infrastructure: 6 500 km of paved roads, a railway, airports and deep-water ports such the one in Abidjan. These still exist but are starting to deteriorate for lack of maintenance. Regional trade no longer goes through Abidjan but via Senegal, Togo or Ghana.

An 87 km motorway is planned between Singrobo and Yamoussoukro, as well as a railway link to Mali and Niger, but the political crisis has prevented a start on them. A national decentralisation plan has also been halted by the civil war. The number of provinces has been cut from 58 to 56, but plans to reduce the number of regions are on the back burner. In contrast, the number of municipalities is to be increased from 198 to 666, with most of the increase in rural areas, and 400 villages are to be created, with decision-making powers devolved to them.

Côte d'Ivoire will need to restart its infrastructure and reform projects and its much-delayed privatisation programme as soon as the political crisis ends. Priorities include divesting the national refinery company SIR and restoring financial order to the state-owned water and postal services.

Institutional and organisational weaknesses in the cocoa and coffee sectors also need to be tackled. An audit has exposed corruption, insider trading and other irregularities in the BCC, and confirmed the ineffectiveness of the bodies set up in 2001/02 to stabilise prices.

Water and rural electrification are also neglected priorities. Groundwater is expected to be tapped out by 2010 and is already highly polluted by rapid urbanisation. The failure to maintain plant and equipment in the water system is putting both supply and public health at serious risk. Gas-powered generators make Côte d'Ivoire a net exporter of energy: it produced 4 867 GWh in 2002, of which an estimated 3 047 GWh were consumed locally. Many villages still have no electricity, however, despite the government's declared intention of connecting 200 a year to the national grid. Just under a quarter of the rural population has access to electricity, compared with 77 per cent in towns and 88 per cent in Abidjan.

Until the war, Côte d'Ivoire was regarded as the most computerised country in the region, with more than 40 companies in the information technology sector. The telecommunications sector was also booming since the privatisation of Côte d'Ivoire Telecom and the sale of the first GSM licence in 1997. Two mobile phone operators share the market, led by Orange, which had 520 000 subscribers at the end of 2002.

The business climate has greatly deteriorated since September 2002, and the events of November 2004 made the environment still worse for the private sector. In mid-November 2004, the national chamber of commerce and industry (CCI) reckoned 10 000 direct jobs had been lost as a result and 100 businesses closed. Of 147 subsidiaries of major French firms, 135 were merely marking time after the flight of three-quarters of their expatriate employees. The damage is especially serious since each Ivorian employee supports 10 to 20 other people.

Small and medium-sized enterprises and industries (SME/SMI) have been the main victims of the crisis. The violence and looting in Abidjan severely damaged the 600 small businesses owned by the French expatriate community, and many entrepreneurs left the country for good. The destruction of SMEs left many Ivorians without jobs and will also mean less tax revenue for the government. Some firms that survived may move to more stable countries in the region such as Senegal, Togo and Benin.

Before the crisis, more than three-quarters of the country's businesses were SMEs, which accounted for about 12 per cent of domestic investment, 17 per cent of GDP and 20 per cent of jobs. A 1999 CCI survey of a representative sample of 506 firms showed that 26 per cent were medium-sized businesses (21-50 employees), 36 per cent small ones (6-20 employees) and 8 per cent micro-enterprises (fewer than 5 employees), with 5 per cent not saying how many people they employed as they were almost certainly using illegal immigrants.

The national tax authorities estimate that the informal sector has at least 45 450 businesses, 2 per cent of them large firms, 20 per cent SME/SMIs, 22 per cent sole proprietorships and 56 per cent micro-enterprises. The latter are mostly in the services and commerce sector and have organisational problems that keep them out of the formal sector.

The government has increased tax breaks for private firms, especially those destroyed or affected by the war. It also wants to raise money for reconstruction through a 1.5-2.5 per cent tax on salaries and a 2 per cent tax on firms' overheads.

The government has also given firms tax relief to help them recover from damage and losses during the violence of 6-7 November 2004. This includes exemption from employers' contributions for November and December of that year or for all of 2005 in the case of businesses that were physically damaged, exemption from trading licence fees and property taxes, exemption from VAT on destroyed fixed assets, tax-free loans and reduction of the guarantee required for the import collection credit from 200 million to 50 million CFA francs.

The port of Abidjan also exempted firms from warehouse charges between 7 and 21 November, and the government promised to increase security in some business zones. French business owners set up an organisation (ADESCI) to win compensation, a freeze on bank loan repayments and a guarantee they could wind up their firms without having to pay redundancy allowances or taxes.

Ivorian SMEs are mostly run in a modern manner, with regular accounts, and are also innovative, especially in consultancy, communication and advertising, though they suffer from a lack of technical skills and access to funding.

Two-thirds of SMEs are started up with the founder's own capital, and the rest use supplier credit or borrow from relatives, friends or the informal financial sector.

Several international bodies are funding development and reconstruction projects in Côte d'Ivoire, and the government has often arranged (by ministerial decree) institutional, technical and financial support for SMEs through the Institut Ivoirien de l'Entreprise, the Centre de Gestion Agréé and the Fonds Ivoirien de Développement de l'Entreprise Nationale. Where financial support is concerned, the SME guarantee fund (FGPME) is the main operator in the sector, covering all economic activities and offering guarantees to financial institutions for 70 per cent of a project's value, with a ceiling of 150 million CFA francs.

International financial institutions have also tried to help SMEs through credit lines to commercial banks, but the banks are reluctant to bear the exchange rate risk in addition to the commercial risks. Before the crisis, the regional stock exchange (BRVM) in Abidjan was planning to open a third department exclusively for SMEs.

The country had 16 micro-credit institutions in 2000, with 287 offices and about 331 000 customers, whereas the regular banking system had only 154 branches. The national federation of savings and credit co-operatives (Fenacoopec), which has 68 per cent of the country's micro-credit market (152 offices, 291 000 members and 7.8 billion CFA francs in funds), has seen its proportion of bad debts rise from 6 per cent in 1999 to 36 per cent in 2001.

Generally speaking, these facilities are of doubtful effectiveness. They do not finance start-ups, which means that small operations seeking to leave the informal sector are excluded. In many cases, the institutions involved also lack material and financial resources as well as the premises they need to operate properly. Lastly, disbursement of funds is a long and complicated process unsuited to the urgent financial needs of SMEs.

Political and Social Context

National reconciliation is going very slowly, and the commitments made under the July 2004 Accra III agreement are far from being fulfilled. The country is cut in two, with the north in rebel hands and the south under government control.

Violence erupted several times in 2004. Opposition demonstrations were banned in March and brutally crushed. The disarmament of the former rebels was supposed to take effect on 15 October 2004, beginning in the northeast zone, but the rebels did not meet the deadline. In response, government troops broke the ceasefire implemented in July 2003. Rebel-held areas in the north were bombed, and the attack also killed nine soldiers of the French Unicorn Force helping to keep the peace along with UN troops. France immediately retaliated by destroying the Ivorian air force, which was followed by riots, looting and other violence in Abidjan, directed against Europeans and the French in particular. At one point, French troops opened fire on the crowd, and the incident left 2 226 wounded (291 of them with bullet wounds) and 57 dead. More than 7,000 French citizens were evacuated.

The UN Security Council immediately imposed a 13-month arms embargo on the country, froze the government's assets and banned travel by anyone obstructing implementation of the peace agreement. The decision was approved by the African peacekeeping commission. The African Union also decided to get more deeply involved and named as mediator South African President Thabo Mbeki, who proposed a "road map" to government and rebels on 6 December after visiting Abidjan.

Of 16 peace measures that were to be passed before the end of October 2004 under the Marcoussis peace agreement, Parliament adopted only seven on schedule, but the two most sensitive measures – on nationality and amending Article 35 of the national constitution, which concerns presidential eligibility – were finally passed in December. A conflicting interpretation of the constitution resulted in one side proposing a referendum and the other urging President Laurent Gbagbo to promulgate the new Article 35 on the grounds that the physical division of the country made a referendum impossible.

Elections have been much delayed, and those due in October 2005 may be compromised because of disagreement about how to implement the new Article 35 and because disarmament, a necessary preliminary to national reunification, has not yet begun. The reconciliation pledged by the politicians is going very slowly. The independent electoral commission responsible for organising the elections was not yet operational as of early 2005. The elections may well be postponed to avoid the risk of a constitutional crisis, as Gbagbo's term expires in October and that of parliament in November. Restoration of government services, which also depends on disarmament, has so far been restricted to a test area in the western buffer zone.

The United Nations Operation in Côte d'Ivoire (UNOCI) has been reduced in size but continues to investigate human rights abuses, which are all too frequent. The UN Human Rights Commission has put out a report on the violations by both sides since September 2002.

Côte d'Ivoire ranked 161st out of 175 countries in the 2003 *Human Development Report* of the UN Development Programme (UNDP), with 38.5 per cent of households living below the poverty line of $1 a day, up from 36 per cent in 1998. Per capita GDP, in current CFA francs, is falling steadily, from 469 500 in 2002 to 455 200 in 2003 and 453 400 in 2004.

Health and education indicators have plummeted as a direct result of the war, though the physical division of the country has prevented data collection in the north. Overall life expectancy is falling and infant mortality rising. The number of tuberculosis cases has increased by an average of 10 per cent a year since 1997. The cost of treatment is high and the disease's resistance to standard treatment is hampering the fight against it.

Côte d'Ivoire has nine doctors for every 100 000 people and only 0.8 of a hospital bed for every 1 000 people. Drinking water is polluted and causes disease. Some regions have become cut off, as the war has badly degraded the country's roads.

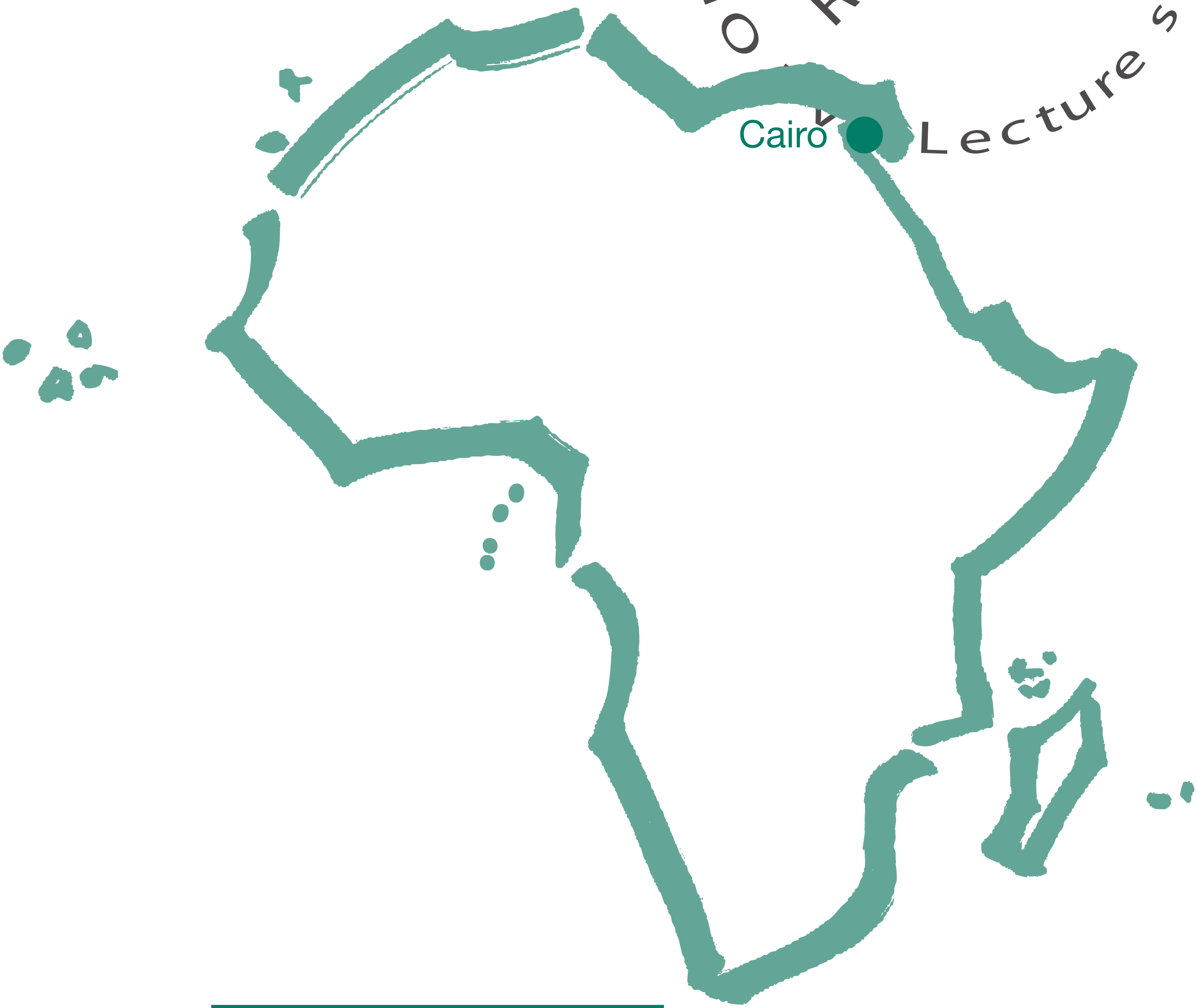
Spending to fight HIV/AIDS has been sharply reduced, and Côte d'Ivoire is the country worst-hit by the disease in West Africa. Some 770 000 adults (9.7 per cent of those in the 15-49 age group) and 84 000 children under 15 are infected. About 420 000 children had lost at least one parent to AIDS by 2001. In 2002, an estimated 9.5 per cent of pregnant women in urban areas were infected and 5.6 per cent in the countryside. A drop in life expectancy is predicted in 2005 because of increased adult mortality, mainly due to AIDS.

Only 49.7 per cent of Ivorians were literate in 2001 (60.3 per cent of men and 38.4 per cent of women), but these figures should fall considerably because of the dearth of teachers in rebel-held areas. Some 4 500 volunteers have over the past two years replaced teachers who have fled the rebel areas to live in government-controlled towns and cities, but they have no teacher training or other relevant training.

Education levels therefore vary widely throughout the country. Some children have not been to school since the crisis began in September 2002. The government, helped by the World Food Programme and the UNDP, wants to reopen nearly 1 250 canteens in former rebel areas and set up new ones so that all primary schools can provide meals (costing a mere 25 CFA francs).

If the crisis ends in 2005, Côte d'Ivoire could negotiate a post-war economic programme and then, with the resumption of budget aid and completion of a poverty reduction strategy paper (PRSP), obtain a poverty reduction and growth facility (PRGF) with its development partners. The country must hope to recover its legendary political stability and its status as sub-regional leader ensuring balance in this part of Africa.

Egypt



key figures

• Land area, thousands of km²	1 001
• Population, thousands (2004)	73 390
• GDP per capita, $ (2002/2003)	1 115
• Life expectancy (2000-2005)	68.8
• Illiteracy rate (2004)	41.5

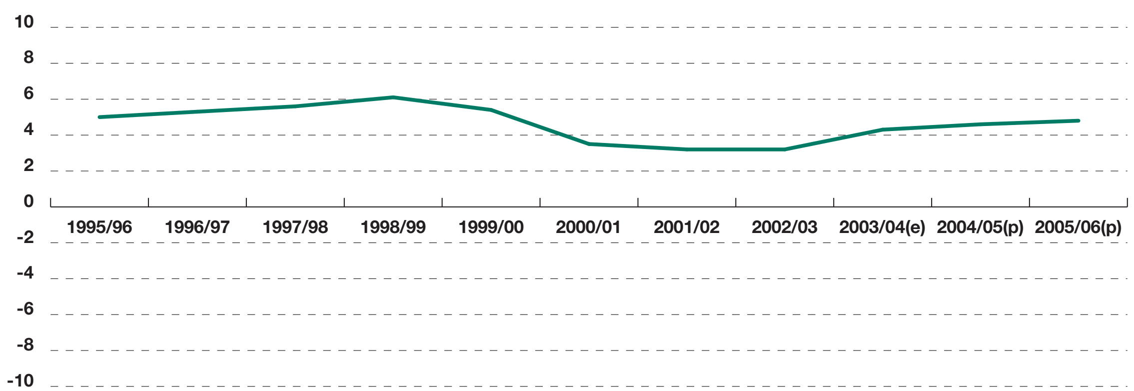
THE GROWTH OF THE EGYPTIAN ECONOMY, driven primarily by export revenue and improved external competitiveness, has revived since mid-2003, returning to rates identical to those of the 1990s, at close to 5 per cent. Exports have benefited from the 25 per cent depreciation of the national currency against the US dollar following the introduction in January 2003 of a partially floating exchange rate, and the current account showed a surplus of nearly $3.7 billion at the end of the 2003/04 fiscal year (1 July 2003-30 June 2004). This surplus, accompanied by a strict monetary policy, has also addressed the problem of availability of foreign exchange, which was holding back imports. The depreciation has, however, contributed substantially to the importation of inflation. The official inflation rate in 2003/04 was 8 per cent, but this depends on the calculation method used; it could in reality be in double figures.

Although the economy is sensitive to external shocks and regional insecurity, growth prospects are significant, particularly in the tourism and natural gas sectors. The Suez Canal is generating substantial profits, and demand for reconstruction in the Persian Gulf has revitalised the construction sector.

An ambitious programme of economic reforms is currently underway.

Structural reforms have made little progress in the last few years, but after the ministerial reshuffle of July 2004, the new cabinet set to work to advance trade and financial liberalisation and the economic and structural reform programme. In 2004, the

Figure 1 - **Real GDP Growth**

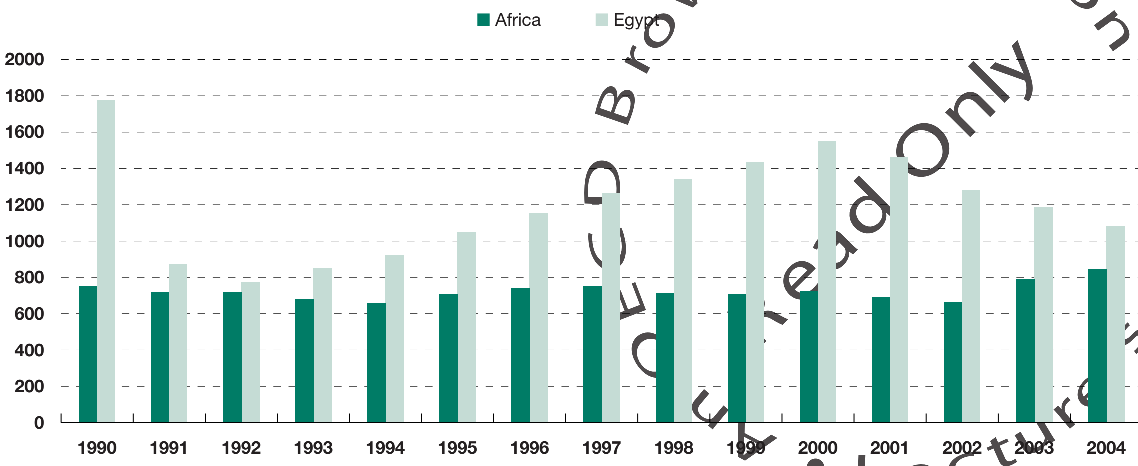


Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

number of customs tariff rates was reduced from 27 to six and the average rate from 14.6 per cent to 9.1 per cent. In 2005, the banking sector is to undergo a major privatisation, restructuring and recapitalisation programme, along with the introduction of stricter prudential ratios. The 2005 presidential elections are expected to result in the re-election of the current president, who has been in office since 1981, but the Egyptian economy is currently in an important phase of transition from centralised economy to market economy.

The country's leaders will also need to tackle two major challenges. First, growth is insufficient to absorb the number of unemployed, and the official unemployment rate, which is rising steadily, exceeded 10 per cent in 2004 and is creating large pockets of poverty in certain governorates. Second, the budget

Figure 2 - **GDP Per Capita in Egypt and in Africa** (current $)



Source: IMF.

continues to show large deficits, generating a level of public debt which is starting to become problematic. In 2003/04, public debt totalled 98.7 per cent of GDP, as against 89.3 per cent the previous year.

Recent Economic Developments

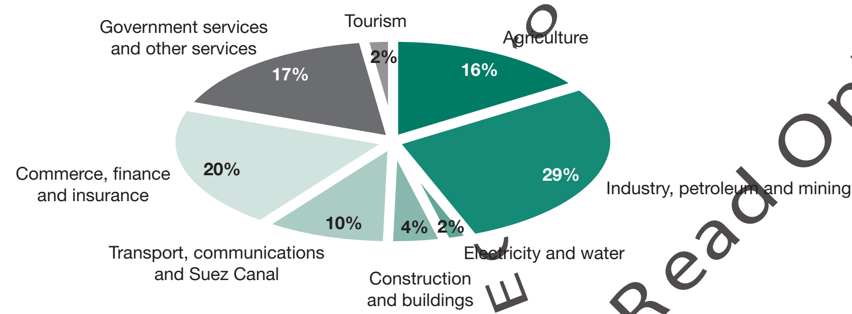
Real GDP grew 4.3 per cent in 2003/04, as against 3.2 per cent the preceding year, and is projected to rise 4.6 per cent in 2004/05 and 4.8 per cent in 2005/06, which would constitute the best performances since 1999/2000. Thus, with average annual population growth at 2 per cent, GDP per capita increased nearly 2 per cent in 2003/04 and should continue to improve.

Agriculture is still one of the pillars of the Egyptian economy, although its contribution to GDP has been diminishing steadily for several decades (it fell from 17 per cent in 1996/97 to 16 per cent in 2003/04), as has its contribution to employment. The agricultural sector recorded a real growth rate of 3.3 per cent in 2003/04. Egypt is unable to feed its population, however, and remains a major importer of food products, which represented 10.8 per cent of imports of 2003/04. With the aim of increasing agricultural output, the authorities have launched huge projects, such as the Toshka project, and plan to irrigate 540 000 hectares of arable land in the desert and the South Valley. There are also prospects for exports of fruit and vegetables to Europe, particularly during the winter months, under the terms of the association agreement which came into force in early 2004. Apart from food products, the Egyptians raise cotton, linen and flowers. Cotton production has fallen sharply in recent years, from 315 000 tonnes in 2001/02 to 190 000 tonnes in 2003/04. International prices, which rose substantially in late 2003 and early 2004, seem to have begun falling again.

In mid-November 2004, the locust invasion that had hit West Africa arrived in Egypt. For the first time in 50 years, the highly agricultural region around Alexandria was invaded by a swarm of insects covering a 60 km front along the Mediterranean coast. The extent of the damage has not been quantified, but it should be relatively limited and localised since the locusts soon left the country.

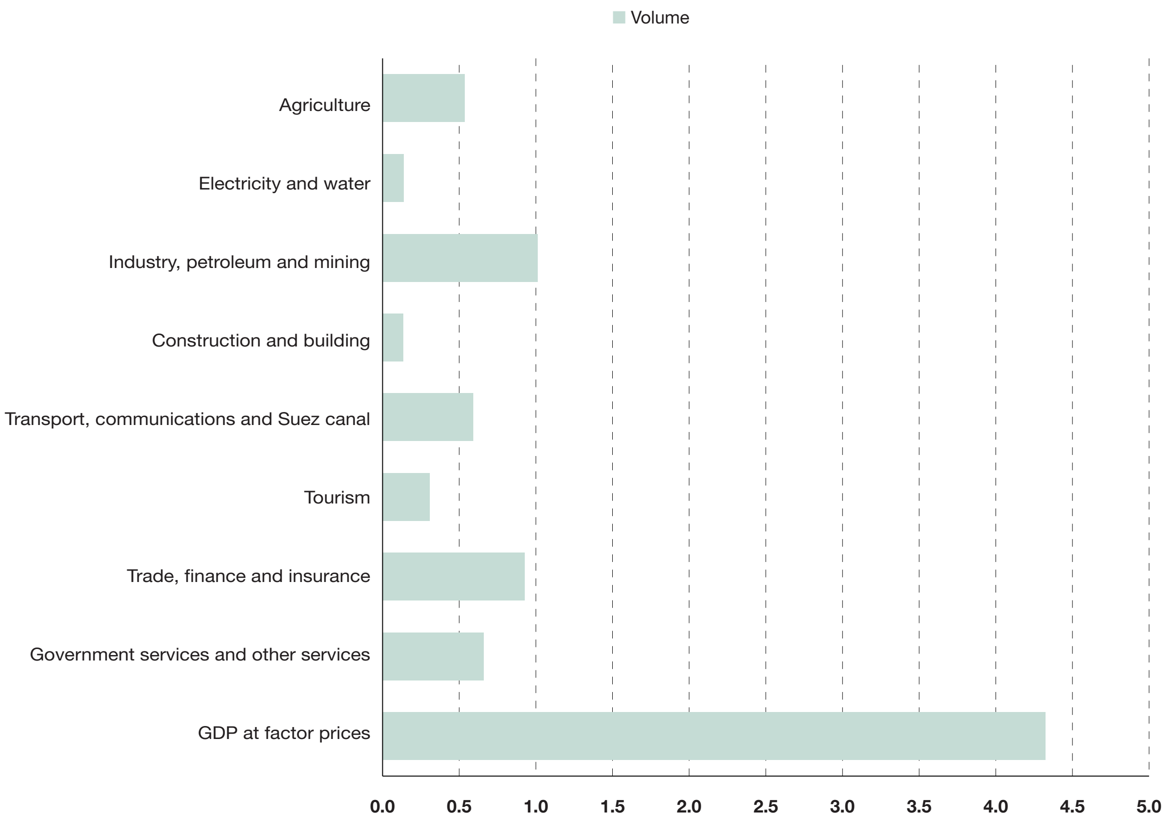
The oil and gas sectors account for about 9 per cent of GDP and one-third of exports of goods. They are very attractive for foreign investors. Reserves continue to be boosted by regular discoveries, and natural gas production is booming: it has increased 75 per cent over the last five years and totalled 3.3 billion cubic feet per day at the end of 2003/04. Proven gas reserves amount to 62 000 billion cubic feet and have increased three-fold in ten years. The first two liquefied natural gas (LNG) production plants were due to open in late 2004 and mid-2005, opening the way for exports of Egypt's natural gas. In contrast, oil production is declining. From

Figure 3 - **GDP by Sector in 2003/04** (percentage)



Source: Authors' estimates based on Central Bank data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003/04** (percentage)



Source: Authors' estimates based on Central Bank data.

more than 920 000 barrels per day in 1995, production fell to under 620 000 barrels per day in 2004. New discoveries have kept the amount of proven oil reserves stable since 2001 at slightly under 3 billion barrels.

The manufacturing sector, consisting mainly of food processing and textiles, generated 20 per cent of GDP and 14 per cent of employment in 2003/04. The construction sector has benefited from strong regional demand for reconstruction from the Persian Gulf countries and the devaluation of the Egyptian pound. As a result, the sector's export revenue, overall output and prices have increased. Cement exports have soared from 67 000 tonnes in 2000/01 to more than 4.2 million tonnes today, whereas domestic demand for cement has remained relatively stable, rising from 25.5 to 26.4 million tonnes over the same period.

The services sector accounts for about half of Egypt's GDP. Its principal components, the Suez Canal and tourism, constitute a major source of foreign currency and an engine of economic growth. In 2003/04, despite regional insecurity, the number of tourists rose to over 6 million. Tourists spent nearly 53 million nights in the country and spent $4.6 billion. The upward trend continued with record-breaking revenues in the first half of 2004/05, and prospects for further growth are favourable even though the government has decided to increase taxation of tourism. Suez Canal revenue has continued to increase, from $2.31 billion in 2002/03 to $2.82 billion in 2003/04, partly owing to the deepening of the canal to allow supertankers to use it but also to the increase in military traffic in connection with the war in Iraq and to the depreciation of the US dollar.

The domestic savings ratio has increased since the 1990s, from 10.9 per cent in 1995/96 to 14.9 per cent in 2003/04, but it is still lower than the investment ratio, which stood at 16.7 per cent in 2003/04. Egypt is therefore heavily dependent on foreign savings to finance domestic investment, but the savings ratio is expected to increase sharply, to over 22 per cent, in 2004/05 and 2005/06.

The investment ratio has fallen regularly between 1989/99 and 2003/04, from close to 20 per cent of GDP to 16.7 per cent. The reforms undertaken by the government to create an investment-friendly environment should lift the ratio to 17.2 per cent of GDP in 2004/05 and 18.6 per cent in 2005/06.

The export ratio has been increasing since 1998/99. It improved markedly following the devaluation of the national currency in 2003/04 and is projected to be nearly 30 per cent of GDP during the next two years.

Table 1 - **Demand Composition** (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04(e)	2004/05(p)	2005/06(p)
Gross capital formation	**16.9**	**18.3**	**18.3**	**17.1**	**16.7**	**17.2**	**18.6**
Public	5.6	5.1	4.5	4.6	4.8	4.8	5.1
Private	11.3	13.2	13.8	12.6	11.9	12.4	13.5
Consumption	**89.1**	**86.6**	**86.1**	**85.5**	**85.1**	**77.9**	**76.4**
Public	10.6	11.3	12.5	12.5	12.2	11.6	11.8
Private	78.5	75.3	73.6	73.0	72.9	66.3	64.7
External sector	**-6.0**	**-4.9**	**-4.4**	**-2.7**	**-1.8**	**4.9**	**5.0**
Exports	21.2	17.5	18.3	21.7	25.1	30.3	29.6
Imports	-27.2	-22.3	-22.7	-24.4	-26.8	-25.4	-24.6

Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Fiscal and Monetary Policy

The increases in the budget deficit and public debt have become alarming since 2000/01. Expenditure as a share of GDP increased slightly from 27 per cent in 2002/03 to 27.2 per cent in 2003/04 but should fall to 25.8 per cent in 2004/05 and 25.6 per cent in 2005/06. The government wants to improve the targeting of subsidies and social spending so as to provide benefits for the poorest groups without unduly straining the budget. Nearly 43 per cent of 2004/05 budget expenditure – E£76 billion – was social spending, of which E£9.1 billion was devoted to health and E£25.9 billion to education. Subsidies are on the increase, as their budget share nearly doubled from 2003/04 to 2004/05. This phenomenon is partly due to the devaluation of the Egyptian pound, which makes imports more expensive, but also to the government's

Table 2 - Public Finances[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants[b]	**27.1**	**21.2**	**20.8**	**20.8**	**21.2**	**20.3**	**19.9**
Tax revenue	17.0	14.3	13.7	14.4	14.8	14.0	13.7
Oil revenue	2.7	2.0	1.8	1.4	1.4	1.4	1.4
Total expenditure and net landing[b]	**28.4**	**26.8**	**26.7**	**27.0**	**27.2**	**25.8**	**25.6**
Current expenditure	22.8	22.5	22.6	22.9	23.3	21.9	21.6
Excluding interest	*15.6*	*16.7*	*16.5*	*16.5*	*16.5*	*15.7*	*15.9*
Wages and salaries	6.2	7.0	7.5	7.6	7.7	6.9	6.7
Interest	7.1	5.8	6.0	6.5	6.8	6.2	5.6
Capital expenditure	5.6	4.2	4.0	4.0	3.8	3.8	4.0
Primary balance	**5.8**	**0.3**	**0.2**	**0.3**	**0.9**	**0.7**	**-0.1**
Overall balance	**-1.3**	**-5.6**	**-5.9**	**-6.1**	**-6.0**	**-5.5**	**-5.7**

a. Fiscal year begins 1 July.
b. Only major items are reported.
Source: World Bank data; estimates (e) and projections (p) based on authors' calculations.

decision to add certain foodstuffs such as rice, beans, lentils and tea to the list of subsidised products. In 2004/05, direct subsidies were devoted in descending order to food products (E£11.6 billion), housing for the poorest (E£1.7 billion), pharmaceutical products and health insurance for university students (E£530 million), export development, public transport and farming. In addition, indirect subsidies on energy products (electricity, gas and diesel fuel) increased in 2004/05 to E£23.4 billion.

The budget also provides for investment totalling E£85 billion for huge infrastructure projects such as the Toshka Project, the Al Salam canal for the irrigation of the northern Sinai and the development of Port Said East. Investment spending has accounted for about 4 per cent of GDP for a number of years.

Revenue is set to fall regularly, from 21.2 per cent of GDP in 2003/04 to 20.3 per cent in 2004/05 and 19.9 per cent in 2005/06. The government has calculated that it will lose E£3.5 billion in trade taxes as a result of tariff reform and removals resulting from its association agreement with the EU, and plans to issue E£3 billion in Treasury bills in 2004/05 to make up some of the shortfall. It also receives transfers of profits from public enterprises (22.5 per cent of total budget revenue), from the Suez Canal (5.8 per cent) and from the state oil company (3.6 per cent). The September 2004 reform of household income tax and company tax will also reduce revenue. The highest tax rates have been lowered from 40 to 20 per cent for households and will be cut from 40 to 20 per cent and subsequently to 10 per cent for companies, except in the oil sector, where the rate will remain 40.55 per cent.

The recent rise in oil prices had no major impact on the budget, as the resulting increase in revenue was offset by an increase in subsidies. The impact was felt, however, in the form of price hikes for the main oil products and in the value of exports of crude oil and oil products, which increased by 25.6 per cent from 2002/03 to 2003/04.

The budget deficit remains large, at 6.1 per cent of GDP in 2002/03 and 6 per cent in 2003/04, partly because of the scale of subsidies on basic products and partly owing to the wage bill and debt service. The deficit should fall to 5.5 per cent in 2004/05 and 5.7 per cent in 2005/06. According to the document approved by the People's Assembly, the 2004/05 budget deficit, which is expected to amount to E£52.3 billion, should be financed largely by the issue of E£37.5 billion in Treasury bills and bonds, and by an increase in public sector demand for bank lending.

The expansionist budgetary policy of recent years was certainly appropriate in a context of economic slowdown. The deterioration in the budget deficit and the public debt, which amounted to 98.7 per cent of GDP in 2003/04, is posing a threat to macroeconomic stability, however, and could have harmful repercussions on control of monetary policy.

The main objective of the Central Bank of Egypt (CBE) under its new governor is to stabilise inflation and the money supply. The CBE steadily tightened its monetary policy and substantially increased interest rates during the first half of 2004. For example, the inter-bank interest rate rose from 5.9 per cent in January 2004 to 10.75 per cent in December. The lending rate in December 2004 was 13.33 per cent and the borrowing rate 7.91 per cent.

The banking sector continues to be handicapped by the high level of doubtful loans, estimated at 20 to 30 per cent of total loans. Domestic credit increased only 9 per cent in 2003/04, but lending to the public sector rose more quickly than that to the private sector; the public sector share of total credit stood at 29.9 per cent, as against 26.7 per cent in 2002/03. The banks continue to be cautious and are wary of small private-sector entrepreneurs. The government is planning to carry out a major restructuring programme in 2005 and to impose stricter prudential ratios.

The national currency stabilised in relation to the dollar after the sharp devaluation which followed adoption of a partially floating exchange rate regime in January 2003. There are some remaining constraints on international transactions in Egyptian pounds. The shortage of foreign exchange, which was holding back trade, has nevertheless become less acute since early 2004, and the government has abolished the currency "requisitioning" it had been imposing on exporters since March 2003. This improvement was due to the government's tight monetary policy, combined with the current account surplus, and the gap between the official exchange rate (E£6.22 to the dollar in December 2004) and the black market rate has virtually disappeared. At the moment, currency reserves cover about 10 months of imports. Nevertheless, the inter-bank foreign exchange market records only small transactions, as banks keep their foreign currency for their customers. In March 2004, the level of dollarisation of the economy, as measured by foreign currency deposits as a percentage of total liquidity, stood at 28.4 per cent.

In August 2003, the government revised its method of calculating inflation based on the consumer price index to bring it closer to the wholesale price index. Use of the consumer price index leads to underestimation of price increases, since subsidies and price controls on basic products and housing protect consumers and the poorest groups against excessive price increases. The wholesale price index, in contrast, reflects not only the prices of imported goods and services but also the cost of living of the middle and upper classes. Depreciation of the Egyptian pound contributed to the importation of inflation, and wholesale prices increased 21.4 per cent between April 2003 and April 2004. Estimates of annual inflation in 2003/04 therefore range from 5.5 to 16 per cent, depending on the sources and calculation method used, compared to 4 per cent the previous year. Taking the average inflation rate to be 8.1 per cent in 2003/04, it should fall to 7.7 per cent in 2004/05 and 6.6 per cent in 2005/06.

External Position

The association agreement signed with the European Union in June 2001 came into force on 1 June 2004. During its first phase, the agreement gives Egyptian exporters free access to the European market for industrial goods, and for agricultural goods that do not compete with European production. In return, Egypt will progressively reduce the import tariffs applied to four categories of goods, over a period which varies according to the category: imports of raw materials and capital goods will be fully deregulated in 2007, those of semi-finished goods in 2010, those of consumer goods in 2013 and those of motor vehicles in 2016. The agreement also provides for the EU to supply aid totalling 615 million euros and loans totalling 1.1 billion euros for the restructuring of Egyptian industry. The EU is Egypt's principal trading partner, with a roughly one-third share of both exports and imports. The implementation of the association agreement should result in trade diversion and thus increase the share of trade with the EU.

Egypt signed an agreement with the United States, its second biggest trading partner, in 1999. The Trade and Investment Framework Agreement (TIFA) provides a mechanism for the promotion of free trade between

Table 3 - Current Account (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04(e)	2004/05(p)	2005/06(p)
Trade balance	-14.3	-10.4	-8.9	-8.3	-10.0	-9.6	-9.7
Exports of goods (f.o.b.)	7.0	7.8	8.4	10.2	13.8	13.0	12.2
Imports of goods (f.o.b.)	-21.3	-18.2	-17.3	-18.5	-23.8	-22.6	-21.9
Services	7.9	5.0	4.3	6.3	10.2		
Factor income	0.8	1.2	0.3	-0.1	-0.3		
Current transfers	5.3	4.1	5.0	4.5	5.3		
Current account balance	**-0.3**	**0.0**	**0.7**	**2.4**	**5.1**		

Source: Central Bank data; estimates (e) and projections (p) based on authors' calculations.

the two countries. The expiry of the Multi-fibre Agreement on 1 January 2005 and growing competition from Asian countries in the textile sector have obliged Egypt to revise its trade strategy with respect to the United States, since clothing and textiles are now subject to customs duties ranging from 10 to 39 per cent. As a result, Egypt signed an industrial and trading partnership with Israel in December 2004, which ensures free entry to the United States for Egyptian products produced in "qualified industrial zones" using 11.2 per cent of Israeli components. Egypt is also a member of the Greater Arab Free Trade Area (GAFTA) with the 11 countries of the Arab League, and has concluded a smaller-scale trade agreement with Tunisia, Morocco and Jordan under the terms of the Agadir Agreement, which should result in a free-trade area in 2005. Egypt has also belonged to the Common Market for Eastern and Southern Africa (COMESA) since 1998, but this market accounts for less than 2 per cent of its imports and exports.

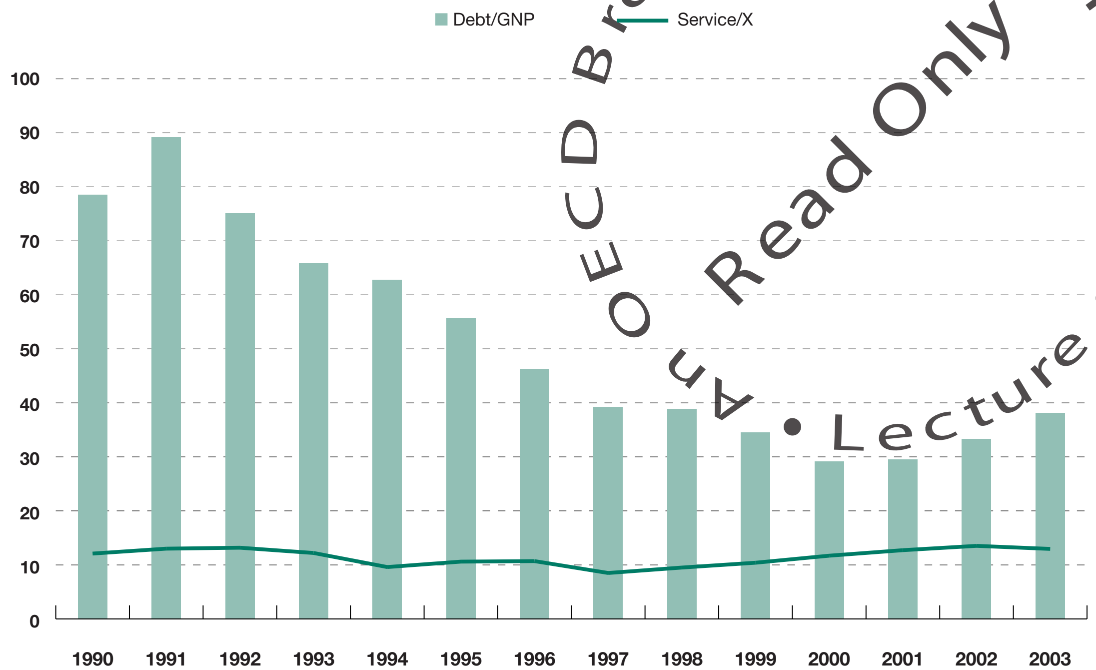
In September 2004, a thorough reform of customs tariffs was undertaken to comply with Egypt's commitments to the World Trade Organisation. The number of rates came down from 27 to six and the rates on certain products were reduced, with the result that the average tariff rate applied to imports fell from 14.6 to 9.1 per cent. This reform constitutes progress towards trade liberalisation, although the General Organisation for Import and Export Controls (GOIEC), which is responsible for checking that imports meet international environmental and employment standards, could be used to re-establish a degree of protection in the form of non-tariff barriers.

Egypt's international trade in goods and services increased strongly in 2003/04, and the current account shows a surplus of more than $3.7 billion, representing 5.1 per cent of GDP, compared with 2.45 per cent the previous year. The trade balance shows a deficit of around 10 per cent of GDP, which should diminish in 2004/05 and 2005/06. In 2003/04, imports remained stable in volume terms, but their price in national currency increased significantly. In value terms, the principal imports are capital equipment such as machinery and electronic components, vegetables and chemical products. Exports showed strong growth as a result of the depreciation of the national currency, which restored price competitiveness, and the increase in world oil prices, which had a positive impact on export revenue. Exports of iron and cement doubled from 2002/03 to 2003/04 and gas exports could become a major foreign exchange earner from 2005 when production of liquid natural gas is due to get underway. Egypt has been exporting gas to Jordan via a new pipeline since 2003, and revenue is expected to rise. It should reach $200 million from 2005 and $1.3 billion from 2007/08.

The balance of services also benefited from the improvement in the country's competitiveness. Suez Canal revenue increased 22 per cent in relation to 2002/03 and revenue from tourism rose 40 per cent over the same period. As a percentage of GDP, services rose from 6.3 per cent in 2002/03 to 10.2 per cent in 2003/04.

The capital account, however, continued to show a deficit of close to $5 billion in 2003/04, nearly three times that observed in 2002/03 ($1.7 billion). Net flows of foreign direct investment have fallen sharply,

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

from $1.2 billion in 2000/01 to just $216 million in 2003/04. Foreign investors – especially European investors, which have substantially reduced their capital flows – were reluctant to invest in the country, principally because of regional security problems. At the same time, Egyptian banks made substantial investments abroad. The new fiscal incentives for investment aim to reverse this trend.

The low levels of debt service and external debt (most of which is concessionary and long-term debt) remain major advantages for the Egyptian economy. External debt stood at $29.4 billion in March 2004. It is relatively stable in absolute value terms but is increasing as a percentage of GDP expressed in US dollars. Owing to the sharp depreciation of the Egyptian pound with respect to the dollar, the debt represented about 30 per cent of GDP in 2000 and 39.7 per cent in March 2004, although the dollar amounts were similar. Debt service is low at 12.1 per cent of exports of goods and services in 2004/05, up from 11.1 per cent in 2003/04.

Structural Issues

The new government has initiated a great many structural reforms, but some of them are progressing slowly and legislative bills dealing with such subjects as export promotion, financial markets and taxation have been delayed several times. A major challenge is the reform of the policy on subsidies, notably in energy. Prices of oil products (apart from benzene, which is used to bake bread) have risen recently following increases in world prices, but they remain below international prices and sometimes below production cost. For example, the price of diesel increased by 50 per cent in October 2004 but it sold at the pump for E£0.40 per litre, which is less than $0.07. This policy of subsidisation is putting an increasing strain on the budget owing to the increase in domestic demand and the depreciation of the national currency. The Oil Ministry estimates the implicit and explicit cost of these subsidies in 2003/04 at E£24 billion, or one-sixth of total public spending. Moreover, the steady rise in oil consumption since the 1990s is depriving the economy of part of the revenue from one of its principal export products. In 2003/04, Egyptians consumed 475 000 barrels per day, as against 460 000 the preceding year, and the figures are expected to increase as economic activity picks up. To conserve oil export revenue, the government has converted 63 per cent of its thermal power stations to gas. It has also announced that it will concede 14 000 square km of land to various foreign companies for exploration purposes. At the same time, it is trying to develop its natural gas export capacity by building gas pipelines. Egypt could become the world's sixth largest natural gas exporter by 2007.

Air and water pollution have become a major problem for the country, and environmentalists have warned the government against major development and irrigation projects. They are seriously concerned about water management – not management of Nile water resources *per se*, but of the way this water is allocated over the national territory and its polluted state.

The World Bank has approved a $335 million loan for the construction of new terminals at Cairo and Sharm El Sheik airports so as to keep up with growth in the tourist sector. The government has also launched a E£140 million project to modernise ports, streamline customs procedures and improve management of port data so as to reduce customs clearance time for goods. As regards road traffic, Egypt has a very high number of accidents due to the poor state of roads but also, and especially, to excessive speed and failure to comply with the rules of the road. In 2003, these factors caused the deaths of 8 000 people and left nearly 320 000 others injured.

The privatisation process has fallen well short of its initial objectives and of the 314 public sector companies targeted by law 203 in 1991. Since 2000, the process has been idling along, and in 2003/04 only nine of 35 planned privatisations were carried out, bringing in proceeds totalling E£114 million. Nevertheless, the state must eventually withdraw from certain key sectors to allow modernisation of production techniques, better resource allocation and improved competitiveness. The banking sector is particularly concerned because the "big four" public sector banks alone hold about half the sector's assets, although they also hold more than a third of doubtful loans. The new 2003 banking law increases the minimum initial capital required of commercial banks from E£100 million to E£500 million. This measure aims to consolidate the system through restructuring, liquidations and mergers, as the sector has too many banks and about 50 financial institutions showing very poor performance. Under the terms of the law, the CBE has put back the deadline for compliance with the new requirement to June 2005. It hopes that mergers and privatisations will reduce the number of financial institutions and raise the quality of financial services.

The Cairo and Alexandria Stock Exchange (CASE), has been posting good performance in the services sector since mid-2003. The Hermes Financial Index (HFI) more than doubled, from 738.5 points in July 2003 to 1 577.3 points in July 2004. At the latter date, market capitalisation stood at E£182 billion and the number of companies listed at 794, down from 1 151 in December 2002 following the introduction of new, stricter regulations that are closer to international standards. Just 20 companies, however, accounted for 45 per cent of all trading in July 2004. Foreign investors represented 24 per cent of trading and held a portfolio of stock worth about $400 million.

The mobile telephone and information technology sectors have been deregulated in recent years. Six and a half million Egyptians are now subscribers with one of the two providers of cellular phone service, Vodafone and MobiNil, compared with 4.3 million at the end of 2002. Telecom Egypt, the public sector company which has a monopoly of fixed lines, paid for a licence to set up a third mobile phone operator in 2002 but cancelled the project after failing to find a strategic foreign partner. Egypt has the lowest ADSL subscription charge for individual customers (transmission speed 256 kbps) in the Middle East at $24 per month, but only 3 per cent of the population had a computer in 2004. A 420 km fibre-optic cable now links Egypt and Sudan, and the information technology sector is showing average growth of 15 to 20 per cent a year.

The business climate seems to be improving, and important measures are being taken to stimulate the development of the private sector. The sector seems to have confidence in the new government and its pro-active business policy, although the powerful central bureaucracy is still an obstacle. The government has made very clear its determination to attract fresh investment and create jobs. The Ministry of Investment, established in July 2004, has replaced the former Ministry of Public Enterprise and taken charge of the privatisation programme. In April 2004, parliament adopted a law authorising the use of electronic signatures and set up an authority for the development of information technology. It also amended the law on investment incentives to add a fourth section offering new incentives, the most important of which is the conversion of the General Authority for Free Zones and Investment (GAFI) into a one-stop reception point for the facilitation of foreign investment projects. Recent laws on mortgages, the harmonisation of working conditions, competition and property rights also aim to improve the business environment.

In the small and medium-sized enterprise (SME) sector, the People's Assembly adopted a wide-ranging law in June 2004 for the development of micro-enterprises and small enterprises[1]. This policy is part of Small and Medium Enterprise Policies (SMEPol), a joint project of the Egyptian and Canadian governments. SMEPol was working on a national strategy to improve the competitiveness of SMEs, to be launched in the first quarter of 2005. The development of this sector is an integral part of the government's policy for fighting unemployment, which aims to create 550 000 new jobs per year through 2017. It is counting on small firms to create 350 000 jobs a year.

In 1998, the government identified 3 322 476 small businesses (fewer than 15 employees) and estimated that 38 763 new ones were started every year. The sectors which have the highest number of SMEs are industry, mining, commerce, finance and insurance. The most urbanised governorates (Cairo, Sharkia, Giza and Alexandria, i.e. the Nile Delta and Cairo areas) have the greatest number of small firms, and only 12 per cent of company heads are women. The SME sector accounts for 75 per cent of jobs, 80 per cent of GDP and 99 per cent of the non-agricultural private sector, but only 4 per cent of exports and 10 per cent of fixed capital formation. Eighty-four per cent of Egyptian SMEs operate in leased premises. The informal sector, representing 20 per cent of productive activity, consists of small activities like street stalls, which are very numerous, and manufacturing businesses that rarely have more than 10 to 15 employees. The recent depreciation of the national currency could have boosted their development, but SMEs do not have access to foreign markets. On the other hand, trade liberalisation has increased foreign competition in some sectors.

The law of June 2004 for the development of small and micro-enterprises offers such firms incentives and aids such as technical and financial assistance via the Social Fund for Development (SFD), 10 per cent of the land in industrial and tourist development zones and 10 per cent of public contracts. It also sets up a special SME unit in each of Egypt's 26 governorates so that firms can very quickly obtain a temporary licence and start trading. The long, tedious procedures for obtaining a full licence, which involve 32 steps, can be deferred. The law gives a particularly important role to the SFD, which now serves as the main co-ordinator between SMEs, ministries and foreign investors. First and foremost, it distributes the credits from donors. These funds, received initially at advantageous interest rates ranging from 1 to 4 per cent, are distributed to firms at an interest rate of 7 per cent, designed to cover administrative costs and risks, whereas the bank lending rate is currently 13 per cent. The SFD also provides the companies with various services such as feasibility studies and information about marketing, risks, equipment and machinery suppliers, and so forth. For this purpose, it allocates about half of its resources to the Small Enterprise Development Organisation (SEDO). Lastly, the SFD is to set up funds in each of the governorates to help enterprises obtain loans and financing, as well as a fund to insure them against

1. The June 2004 law defines micro-enterprises and small enterprises. The latter have capital ranging from E£50 000 to E£1 million and employ fewer than 50 people, whereas micro-enterprises have capital of less than E£50 000 and no more than five employees.

financial risk.

Apart from red tape and management problems, SMEs have great difficulty in obtaining loans. Financial institutions blame their lack of accounting systems and financial forecasting for this phenomenon. Only 6 per cent of bank loans are granted to SMEs. The figures from a SMEPol survey also indicate that 78 per cent of small firms have never applied to a bank for financing and that 92 per cent of those that have done so were refused. The figures are even higher for micro-enterprises.

One of the solutions for the small companies is micro-financing. In principle, lines of micro-credit are very substantial because donors (USAID, the International Finance Corporation, Environmental Quality International, the Canadian International Development Agency, the Islamic Development Bank, the Kuwaiti Fund, the European Union and others) are investing heavily in the financing of Egyptian businesses. NGOs, certain commercial banks, the SFD and the Credit Guarantee Company are very active in this field. Egypt is the regional leader where micro-financing is concerned. At the end of 2003, more than 250 000 customers, of whom about 46 per cent were women, had received micro-loans totalling $55 million, and demand remains strong, with the number of potential customers estimated at 2 to 3 million. Small entrepreneurs have two alternatives: to approach a not-for-profit NGO like the Alexandria Business Association (ABA) or to apply to a bank offering micro-financing services.

The funds distributed by donors are relayed by two large banks, the National Bank for Development (NBD) and the Banque du Caire. New banks regularly enter

A Successful Micro-financing Programme run by the Alexandria Business Association (ABA)

ABA is a non-governmental micro-financing organisation whose success is nationally recognised. It grants loans very quickly – 72 hours for renewals, 14 days for first applications – to groups formed for the term of the loan, consisting on average of 100 borrowers headed by an ABA officer. The average amount lent is E£2 641 (about $425) at an interest rate of 18 per cent; 80 per cent of loans are earmarked for micro-enterprises and 20 per cent for vulnerable groups such as the unemployed and women. For loans up to E£3 000, the ABA requires only an identity card or family record book and a home lease or ownership deed.

The loan repayment rate stands at 99.2 per cent, and the number of new applicants is increasing at a rate of 140 per cent a year. The organisation has already covered its operating costs, two years ahead of schedule, and now operates in five governorates and has 28 subsidiaries. One of ABA's innovations has been the way its officers are paid. They receive a basic salary and bonuses based on the number of loans and repayment levels. The organisation also has a technical assistance centre and has contributed greatly to the economic development of the Alexandria area.

Two programmes have recently been launched to help "the poorest of the poor":

- In the Towards Self-Employment Programme, ABA has introduced micro-grants of E£200. This programme is open to the most vulnerable groups, woman and unemployed young people, so long as they have plans to undertake productive activity. The first payment is made on condition that the person works on the project eight hours a day for three months, and the second is made if the venture remains viable and the person available beyond that period. Seventy-four per cent of beneficiaries subsequently joined the micro-credit programme in 2003.
- The Blossoms of Micro-Enterprise Programme is designed for women who are household heads. It grants small loans of E£100-500 to groups of five members, as well as training on family matters such as hygiene, pollution and first aid. In 2003, 31 500 women benefited from this scheme.

the micro-credit market, however. The Commercial International Bank (CIB) and Banque MISR made their appearance in September and October 2003 respectively, in partnership with North Africa Enterprise Development (NAED), and the Export Development Bank of Egypt (EDBE) joined them at the end of 2004 in partnership with the Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA). The loans granted are generally for very small amounts (E£1 000-3 000), however, and interest rates are higher than market rates, at around 20 per cent.

The SMEPol now wants to address access to other sources of finance such as export financing, financial leasing and venture capital. Only one leasing firm, ORIX, finances SMEs without requiring a guarantee. Whereas other companies refuse to lend less than E£2 million, this sum is the maximum amount that ORIX will provide to its customers. SMEs also face problems of export financing and access to foreign markets. Several studies are in progress, notably with EDBE, which wants to set up export promotion units at a number of commercial banks. The idea is to have chambers of commerce act as intermediaries and guarantors for transactions between banks and SMEs.

Political and Social Context

A major ministerial reshuffle took place in July 2004, and several of the incoming ministers are regarded as belonging to a younger generation more open to change and reform. The new ministers were appointed to head the ministries most concerned by the reforms: the Ministry of Industry and Foreign Trade, Ministry of Finance and Ministry of Investment Development.

The president of the Arab Republic of Egypt has broad powers. He appoints first one or more vice-presidents, then the prime minister and the cabinet, and lastly the governors of the 26 provinces. A dozen opposition parties exist, but the party of the current president, the National Democratic Party, dominates both nationally and locally. In this situation, voter turnout for elections is generally low, ranging from 24.1 per cent in the last legislative elections to 42.4 per cent in district elections. The National Council for Human Rights recently called for an end to the state of emergency and an open political system, but the country's leaders favour stability and step-by-step change to avoid opening the door for the extremist parties.

The Egyptian president is chosen in two stages. His candidacy is first validated by a two-thirds majority of the National Assembly, which then submits its choice to plebiscite. President Hosni Mubarak, who has been in office for 24 years, could stand for a fifth term in May before a National Assembly dominated by his party. As candidates from other parties have no chance of being chosen, the opposition has united to call for amendment of the constitution so that the president can be elected by universal suffrage and his powers reduced.

Generally speaking, Egypt has made great progress in social affairs and poverty reduction. The government did not slacken its efforts in 2003/04, investing E£3.7 billion in the education sector and E£2.6 billion in health. Major regional disparities nevertheless remain.

Per capita income has fallen in US dollars at purchasing power parity owing to the sharp depreciation of the national currency. Nationally, GDP per capita was \$3 793 in 2002, as against \$4 878 in 2000. In the Port Said area, however, it stood at \$8 287, compared with \$2 245.30 in the Suhag region in Lower Egypt. In 2002, 20.4 per cent of the population was living below the poverty line, set at \$1 per day at purchasing power parity. Lower Egypt is poorer than Upper Egypt. In the former area, 43.4 per cent of inhabitants either have no access to water or health care or are illiterate or unemployed, compared to 36.7 per cent in Upper Egypt. On the other hand, urban/rural disparities are greater in Upper Egypt, although the figures are tending to improve, in contrast to the rest of the country.

To eradicate poverty, the government is making cash transfers to the poorest, but their impact is not very great. These transfers represented 8.34 per cent of the income of the poorest (E£47 on average) and benefited 897 708 people in 2002.

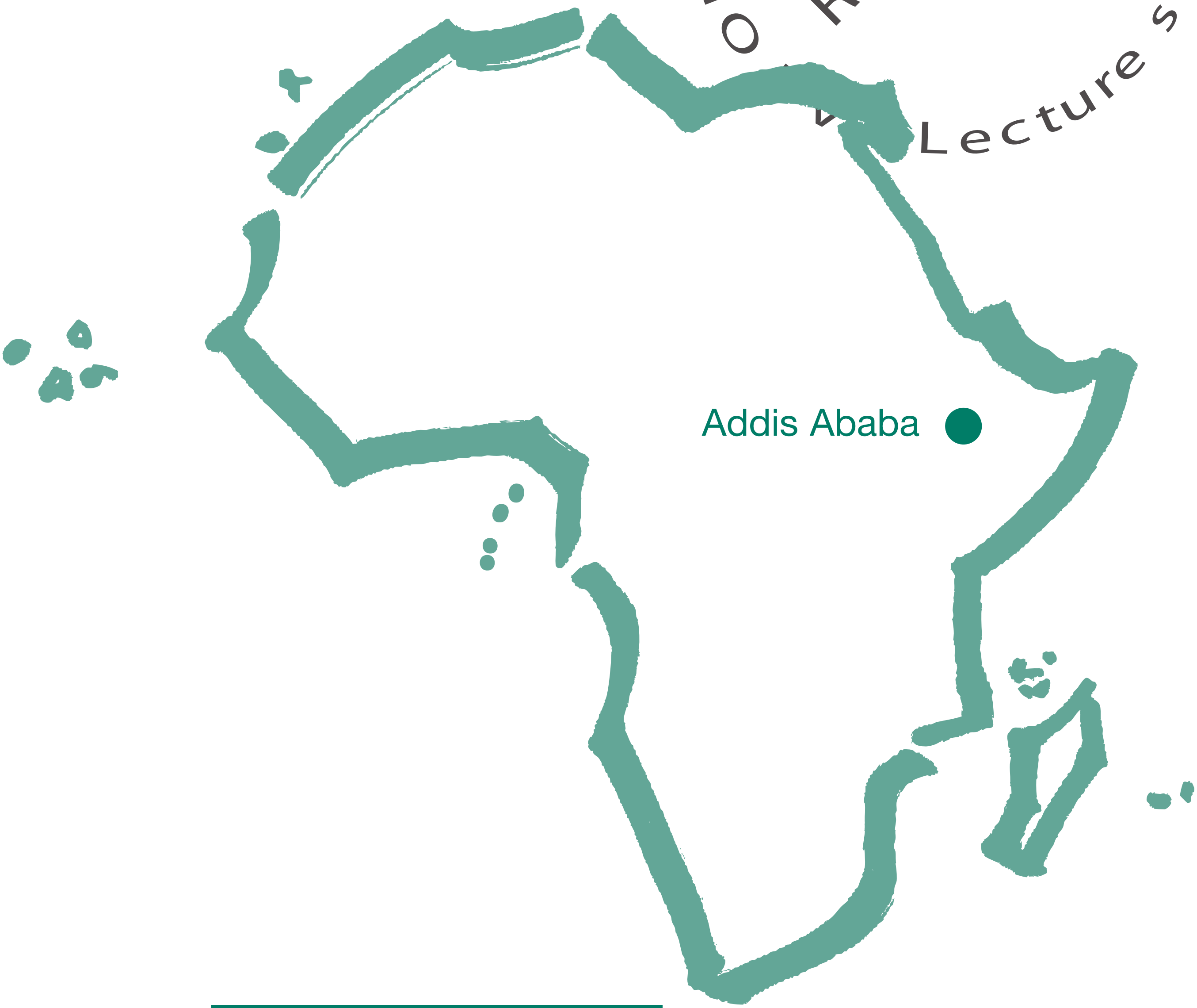
Under the pressure of demographic growth, the job market sees 700 000 to 800 000 new entrants every year. This increases the unemployment rate, which rose from 9.9 per cent of the working population in 2003 to 10.7 per cent in 2004. The employment problem is particularly worrying for young graduates, increasing numbers of whom are failing to find a steady job on completing their education. In 2003, 14.4 per cent of unemployed people were university graduates. More than 23 per cent of women were unemployed in 2004, with the highest rates being found in urban areas. There are strong regional disparities: in the Aswan region, for example, 50.4 per cent of women are looking for work. Under-employment and work in the informal sector are estimated to account for one-third to one-half of GDP.

Life expectancy at birth has improved from 57.1 years on average in 1980 to 72.3 years for women and 67.5 years for men in 2003, as a result of a sharp drop in infant and maternal mortality rates, which have fallen by at least a third since 1980. The main diseases have been eradicated and the estimated prevalence of HIV/AIDS is very low, at less than 0.1 per cent of the adult population aged 15 to 49. The number of doctors, hospitals and beds per capita increased again in 2003/04 and, in line with the same trend, the percentage of the population with access to water and health care exceeded 90 per cent in 2003 for the entire country.

School enrolment rates in Egypt rose from 73 per cent in 1980 to 97 per cent in 2002 for primary education and from 50 to 85 per cent over the same period for secondary education. Considerable disparities remain, however. In 2003/04, more than 40 per cent of women were illiterate, compared with 17 per cent of men, but the figures for rural areas were even more alarming, at 85 per cent and 43 per cent respectively. The problem of educational quality is compounded by the shortage of teachers, especially at the primary level. In 2003/04, the average number of children per primary school class was over 40, a very high level. To deal with these problems, the education reform due in 2005 includes a number of basic proposals such as the establishment of an independent body to monitor the quality and level of education, the adoption of a decentralisation policy, an increase in the number of schools and the eradication of illiteracy among girls. This reform emphasises the quality of education and, to this end, sets much stricter standards for teacher recruitment.

The great majority of children – more than 85 per cent – are educated in the public school system. Others turn to the private providers (6.1 per cent) or to Al-Azhar (8.1 per cent), which is financed by public funds but run by a Koranic religious organisation.

Ethiopia



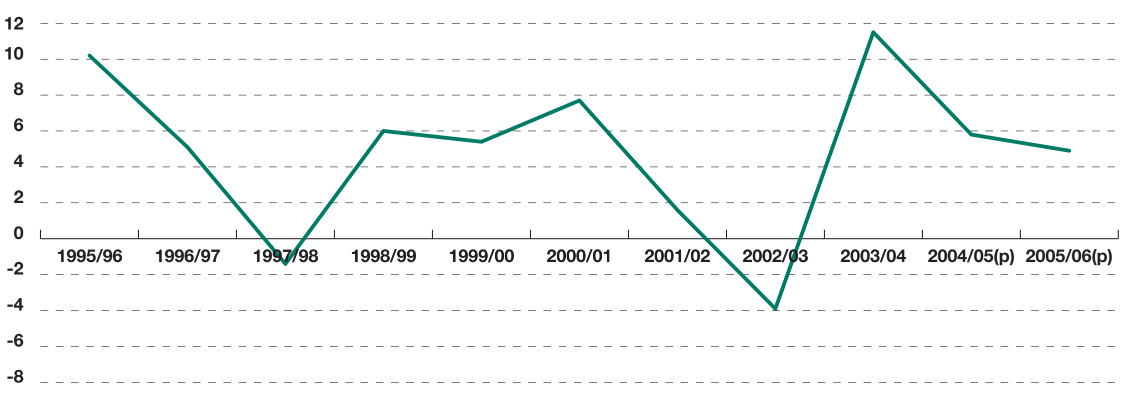
key figures

• Land area, thousands of km²	1 104
• Population, thousands (2004)	72 420
• GDP per capita, $ (2002/2003)	94
• Life expectancy (2000-2005)	45.5
• Illiteracy rate (2004)	56

SHORTLY AFTER THE COSTLY CONFLICT with Eritrea ended in December 2000, Ethiopia was hammered by a series of droughts, increasing already high levels of poverty and requiring massive imports of food aid. The economy made a promising recovery in 2003/04, growing at an estimated 11.5 per cent. Preliminary estimates indicate real GDP growth for 2004/05 in the range of 5.6 to 6 per cent. Inflation has been reduced from over 15 per cent during the last fiscal year to below 10 per cent in 2003/04. Ethiopia continues with the successful implementation of its Sustainable Development and Poverty Reduction Programme (SDPRP), formally adopted in 2002. The core objective of the SDPRP is to promote pro-poor and rapid growth through *a)* proactive development policies; *b)* targeted public interventions; and *c)* an enhanced incentive structure. Based on donors' endorsement of the SDPRP, the government hopes to double the inflow of aid. Ethiopia reached the completion point under the enhanced Heavily Indebted Poor Country (HIPC) initiative in April 2004, which is expected over time to provide the country with nominal debt relief in the amount of approximately $3.3 billion. Under optimistic assumptions, a long-term real GDP growth rate of 7 per cent seems feasible. In addition to the implementation of policies and reforms detailed in the SDRPR, a critical requirement for sustained poverty reduction and growth is internal and external peace. In particular, full resolution of the border demarcation problem between Eritrea and Ethiopia is crucial. Ethiopia has been identified as a potential candidate for Millennium Development Goal (MDG) fast-tracking, which, if it comes to pass, would give Ethiopia a considerable boost in terms of poverty reduction and growth[1].

Economic activity has strongly rebounded following last year's drought.

Figure 1 - **Real GDP Growth**



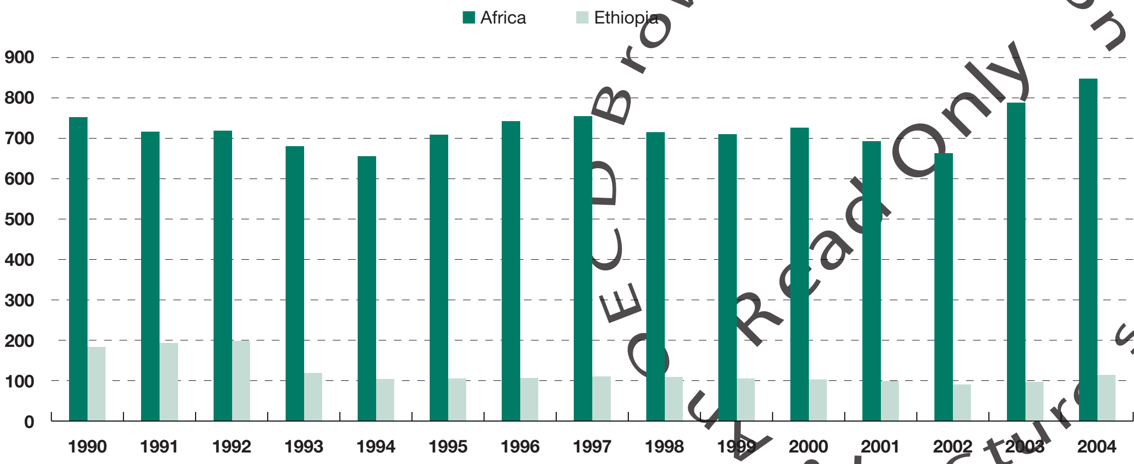
Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

Recent Economic Developments

After the severe drought of the last fiscal year, Ethiopia's real GDP recovered strongly, reaching an estimated growth rate of 11.5 per cent in 2003/04. The strong recovery, led by growth of almost 19 per cent in agricultural output, helped Ethiopia to continue with its economic reform and poverty reduction

1. See the Millennium Project's Report to the UN Secretary-General, Investing in Development – *A Practical Plan to Achieve the Millennium Development Goals*, January 2005.

Figure 2 - **GDP Per Capita in Ethiopia and in Africa** (current $)



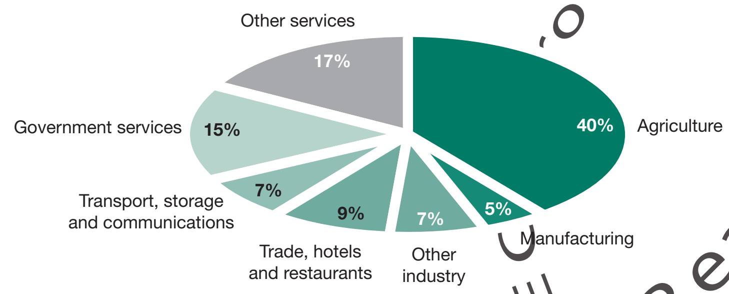
Source: IMF.

programme, with the ultimate goal of reaching the MDGs by 2015. Ethiopia is now targeting medium-term average real GDP growth of 7 per cent, the minimum growth rate necessary for achieving the MDGs. However, preliminary estimates for 2004/05 indicate a real GDP growth rate in the range of 5.6 to 6 per cent. Taking the latest international commodity prices into account and adopting relatively conservative assumptions about future aid flows to Ethiopia, our projections suggest a real GDP growth rate of 4.9 per cent for 2005/06 (see Figure 1). While the double-digit growth rate in agricultural production reflects a rebound from the drought-depressed level of 2002/03, it is encouraging that the recovery was not confined to agriculture. Non-agricultural sectors are estimated to have expanded at 6.8 per cent in 2003/04. At the same time, inflation has fallen to about 9 per cent (after a drought-affected 15.1 per cent in the previous fiscal year). Over the medium term, it is expected that the inflation rate will stabilise at about 5 per cent, reflecting prudent fiscal and monetary policies and assuming normal weather conditions.

The strong recovery of agricultural production in 2003/04 was largely due to favourable weather, resulting in a record growth rate of 19.2 per cent. This implied an increase in the GDP share of agriculture from 40 per cent in 2002/03 to about 45 per cent in 2003/04. The outlook for agricultural production continues to be positive, subject to weather conditions, though the growth rate will – due to the 2003/04 bumper harvest – moderate in 2004/05. Poverty-targeted government expenditures in agriculture have increased from 1.3 per cent of GDP (in 2002/03) to an estimated 1.5 per cent (in 2003/04), and are projected to increase to 1.9 per cent of GDP by the turn of the decade. Although until recently producer prices of coffee have fallen considerably, coffee remains the main agricultural export product.

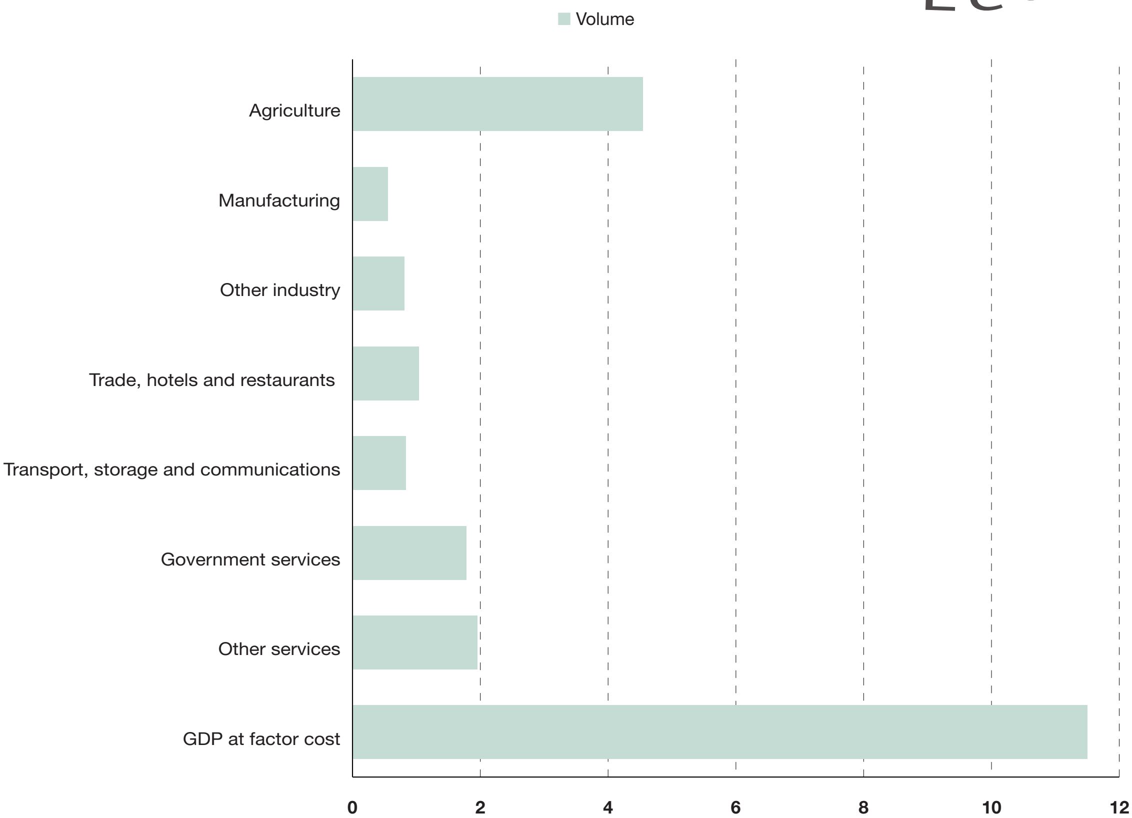
Ethiopia continues to face food insecurity and requires massive food aid, even under favourable weather conditions. Hence, in June 2003, a Coalition for Food Security was established between the government and its development partners, with the aim of attaining food security for 5 million people whose food supply is chronically insecure and of improving the overall food security of an additional 10 million people. Given the deteriorations in land security and increased land fragmentation due to increasing population pressures, the government is currently undertaking various reforms, concentrating on improvements in land tenure and land security, facilitation of voluntary resettlement from drought-prone to land-surplus areas and increased land productivity. Following proclamations on rural land aimed at improving land tenure and land security in four main regions of Ethiopia in 2002/03, rural land proclamations are currently under way in some of the other key emerging regions. It is anticipated that, due to these proclamations, the number of households with

Figure 3 - **GDP By Sector in 2002/03** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2002/03** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

secure long-term land use rights will increase from fewer than 0.7 million in 2002 to over 8 million in 2005/06. Together with other initiatives to increase land productivity, it is anticipated that agricultural production will grow at an average of about 7 per cent over the medium term. Furthermore, Ethiopia's Environmental Protection Agency, established in 2002, is currently formulating policies and strategies to ensure the long-term environmental sustainability of agriculture and rural-based livelihoods in Ethiopia.

Given the strong recovery in agricultural production, the shares of industry and services in GDP were reduced to 10 per cent and 45 per cent respectively, even though real output in the two sectors grew at 6.1 per cent and 6.8 per cent respectively from 2002/03 to 2003/04. Within the industrial sector, manufacturing continues to be the dominant sub-sector, growing at 7 per cent in 2002/03 and an estimated 5 per cent in 2003/04. While the ability to generate hydro-electric power improved significantly due to favourable rains, the estimated 4 per cent growth in the overall electricity sector for 2003/04 is disappointing. Mining and quarrying activities continue to be a major source of growth in the industrial sector, growing at 9 per cent in 2002/03 and an estimated 8 per cent in 2003/04. As there was little demand for new construction following the severe droughts of 2002/03, construction was the slowest-growing industrial sub-sector, expanding by only 3.5 per cent in 2002/03. However, given that construction usually lags behind developments in the overall economy, the growth rate of the construction sector is estimated to have doubled in 2003/04. A positive impact on industrial growth is also expected from the industrial development strategy adopted in 2002, which recognises the role of the private sector as an engine for industrial development. It emphasises export-led industrialisation, the use of labour-intensive technologies and the need to encourage domestic and foreign joint ventures.

Growth in the services sector is dominated by sharp increases in the education and health sub-sectors, reflecting the priorities of the SDPRP. In 2003/04, the education and health sectors are estimated to have increased by 12 per cent and 8 per cent respectively. In 2003/04, transportation and communications are estimated to have grown by 8 per cent and 7 per cent respectively. Prospects for 2004/05 continue to be positive for the communications sector, although structural reforms in telecommunications are making only marginal progress. Growth prospects in the transportation sector are contingent on world oil prices and on the extent to which the state-owned Ethiopian Petroleum Enterprise passes on such price changes.

Gross domestic savings increased slightly from 1 per cent of GDP in 2002/03 to 1.3 per cent in 2003/04, though the savings rate still lags behind the 2001/02 rate of 2.5 per cent of GDP. A matter of

Table 1 - **Demand Composition** (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Gross capital formation	**16.9**	**17.8**	**20.4**	**20.5**	**19.5**	**20.3**	**20.5**
Public	7.5	8.5	11.5	10.5	9.9	10.1	10.3
Private	9.4	9.3	9.0	10.0	9.6	10.1	10.1
Consumption	**93.0**	**96.9**	**97.5**	**99.0**	**103.2**	**104.6**	**105.1**
Public	11.2	16.8	19.3	19.1	17.8	17.9	17.7
Private	81.8	80.1	78.2	79.9	85.4	86.7	87.4
External sector	**-9.9**	**-14.7**	**-17.9**	**-19.4**	**-22.7**	**-24.8**	**-25.6**
Exports	13.1	15.1	16.2	17.1	15.6	14.9	14.1
Imports	-23.0	-29.8	-34.1	-36.5	-38.2	-39.7	-39.7

Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

concern is that the share of private savings in GDP decreased from an already low 0.6 per cent in 2002/03 to an estimated 0.3 per cent in 2003/04. Similarly, the share of private investment is estimated to have decreased from 10 per cent of GDP in 2002/03 to 9.6 per cent of GDP in 2003/04. These decreases in savings and investment shares reflect temporary increases in consumption during the recovery. It is anticipated that private savings and private investment will both pick up significantly in terms of GDP in the coming years. Total consumption is estimated to have increased sharply from 99 per cent of GDP in 2002/03 to 103.2 per cent of GDP in 2003/04, and is projected to grow more moderately over the medium term.

Macroeconomic Policies

Fiscal and Monetary Policy

After a temporary increase in the overall fiscal deficit (including grants) in fiscal years 2001/02 and 2002/03, estimates indicate that revenues continued to increase and expenditures were reduced in 2003/04, resulting in an overall fiscal deficit-to-GDP ratio of 5 per cent in 2003/04. While the overall deficit is expected to decrease further over the medium term, actual developments will depend critically on inflows of grants.

Excluding grants, the overall fiscal deficit decreased from 16.4 per cent in 2002/03 to about 13 per cent in 2003/04 and is expected to remain around 12 per cent over the short term, due to the government's continued commitment to prudent fiscal policy. The government's anticipation of significant increases in grants is not likely to affect the overall budget deficit after grants, as these grants are expected to be used for poverty reduction expenditures.

Excluding expenditures on special programmes, which amount to about 1 per cent of GDP, recurrent expenditures decreased from a high of 23.7 per cent in 2002/03 to an estimated 22.4 per cent in 2003/04. This

Table 2 - **Public Finances**[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants[b]	**21.3**	**23.6**	**24.7**	**27.5**	**27.8**	**25.9**	**27.0**
Tax revenue	12.5	13.7	15.3	14.4	14.6	14.7	14.7
Oil revenue	2.9	4.8	4.7	8.0	8.1	6.0	7.2
Total expenditure and net lending[b]	**26.9**	**29.1**	**34.0**	**35.9**	**32.8**	**32.1**	**32.0**
Current expenditure	14.7	19.1	20.3	23.7	22.4	21.4	21.1
Excluding Interest	*12.3*	*17.2*	*18.4*	*21.6*	*20.2*	*20.2*	*19.9*
Wages and salaries	5.5	6.6	7.3	7.0	6.1	6.0	5.9
Interest	2.4	2.0	1.9	2.1	2.2	1.3	1.2
Capital expenditure	9.4	9.2	11.8	11.1	10.4	10.7	10.9
Primary balance	**-3.2**	**-3.5**	**-7.3**	**-6.3**	**-2.8**	**-5.0**	**-3.8**
Overall balance	**-5.6**	**-5.5**	**-9.3**	**-8.4**	**-5.0**	**-6.2**	**-5.0**

a. Fiscal year begins 1 July.
b. Only major items are reported.
Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

reduction in recurrent expenditures (relative to GPD) should be seen in the light of two factors: *a)* reductions in drought-related emergency expenditures; and *b)* higher than anticipated growth in GDP. Capital expenditure, which decreased during 2002/03 and probably also in 2003/04, is projected to increase considerably over the medium term (see Table 2). Relatively large investments in the education sector are a key factor underlying the projected increase in capital expenditure. There are some concerns about the possibility of higher defence expenditure, especially if the issue of the border demarcation between Eritrea and Ethiopia remains unresolved. Positive prospects for further improvements in Ethiopia's expenditure management are based on *a)* continuous progress in the consolidation of federal and regional budgets; and *b)* recent measures taken to improve the effectiveness, reporting and monitoring of local government expenditure. The level of defence spending in 2003/04 is estimated to have remained constant in nominal terms, and hence to have declined in real terms. Defence spending is projected to decline further in real terms once the border crisis with Eritrea is fully resolved.

Given the low taxation of agriculture, the strong recovery in agriculture entailed a decrease in the ratio of tax revenues to GDP, from 15.3 per cent in 2002/03 to 14.4 per cent in 2003/04. It is estimated, however, that in real terms, total revenues (excluding grants) increased by 7 per cent from 2002/03 to 2003/04, especially due to a sharp increase in import taxes. Revenues from income and profits taxes are estimated to have been significantly lower in fiscal year 2003/04, as earnings fell drastically during the drought. With the strong recovery of personal income and to a lesser extent profits, it is estimated that direct taxes will pick up over the medium term. The level of import taxes as a share of GDP is expected to decrease slightly in 2004/05, as imports return to their normal level. The medium-term outlook for tax revenues is good, based on continued reforms aiming at improving tax collection and enforcement.

Ethiopia's monetary policy continues to seek price stability by targeting monetary expansion to the growth rate of nominal GDP. After a drought-affected 15.1 per cent peak in Ethiopia's inflation rate in 2002/03, inflation fell to 9.6 per cent in 2003/04 and, influenced by favourable weather conditions, is expected to decrease further to 5.4 per cent in 2004/05. Following the contraction of the broad money supply relative to GDP in early 2004 (which was due mainly to a reduction of the government's net domestic debt to the banking system), Ethiopia's central bank is targeting a substantial increase in credit to both the government and the private sector. The central bank has also left its minimum interest rate on savings deposits at 3 per cent and its minimum lending rate at 7 per cent. Following the lead of the dominant Commercial Bank, the banking sector has also continued to adhere to these minimums.

External Position

Ethiopia's official exchange rate continues to be determined through weekly wholesale foreign exchange auctions, though the National Bank of Ethiopia (NBE) reserves its right to intervene through open market operations with the goal of keeping the birr relatively stable against the dollar (in which the majority of Ethiopia's import transactions are denominated). The difference between the official and parallel market exchange rates is narrowing and amounted to less than 1 per cent during 2003/04, partly due to enforcement of foreign exchange regulations, under which it is illegal to exchange foreign currency notes or travellers' cheques other than in designated foreign exchange bureaux. Due to the depreciation of the US dollar against most other major currencies, especially the euro, the birr depreciated in nominal terms, improving Ethiopia's competitiveness, particularly *vis-à-vis* Europe, its major export market. The real depreciation had some negative impacts on Ethiopia's efforts to reduce inflation, due to increased prices of imported goods not denominated in dollars.

The NBE increased its holdings of international reserves, due to strong export performance and higher than anticipated external assistance (of which a part came as delayed emergency assistance). Compared to 2002/03, gross international reserves remained stable during 2003/04, at the equivalent of slightly above four months of imports of goods and services, and stood at the equivalent of about five months of imports at end-June 2004. Hence, while oil price increases did not cause severe problems for Ethiopia's overall balance of payments during 2003/04, they imply a constraint on Ethiopia's capacity to import other important goods, especially if oil prices remain high.

Ethiopia's current account balance is estimated to have significantly improved during 2003/04, and was expected to improve further until recent increases in import prices (especially of oil and steel) dampened the positive outlook. Given that the import volume of petroleum products is considered to be highly inelastic (amounting to about 1.5 million metric tonnes a year during 2002/03 and 2003/04, and about 15 per cent of Ethiopia's total import bill), it is estimated that every 10 per cent increase in the price of oil will increase Ethiopia's import bill by about 1.5 per cent. Hence, while increases in oil prices alone do not seem to have severe effects on Ethiopia, prices of other key imports, especially steel, are closely correlated with oil prices. Hence, import price variations can have significant impact on Ethiopia's external balance. At the same time, there are reasonable expectations of considerable increases in aid flows to Ethiopia, which might counterbalance the increase in import prices. The trade deficit, estimated to have increased considerably from 2002/03 to 2003/04, is projected to reach about 24 per cent of GDP in 2004/05 and 2005/06, largely due to imports. Goods exports, dominated by coffee, pulses and oilseeds, are estimated to have grown considerably in real terms, but have remained relatively stable in terms of GDP from 2002/03 to 2003/04 (due to the estimated real GDP growth rate of 11.5 per cent for 2003/04). Goods exports are projected to increase slightly in terms of GDP share for 2004/05 and 2005/06.

While Ethiopia's merchandise exports continue to be dominated by agricultural products (about 75 per cent of the total), the share of non-traditional exports such as gold and leather products is growing. Furthermore, Addis Ababa continues to be a major city for international fora and conferences. Hence, Ethiopia seems to be making some progress in diversifying its exports, although high volatility of exports of individual products obscures the trend. In view of the fragile situation of many private and public enterprises, Ethiopia is currently not considering further trade liberalisation. The government justifies this on the grounds that it has already made significant progress in recent years in liberalising trade and will continue with its structural reform programme towards a market-based economy.

Ethiopia received inflows of foreign direct investment (FDI) equivalent to slightly more than 5 per cent of gross fixed capital formation in both 2002 and 2003. Over the medium term, Ethiopia expects to double the amount of FDI inflows to about $120 million a year (equivalent to about 1.5 per cent of GDP), especially after signing bilateral investment treaties with Belgium, Iran, Israel, Luxembourg, Mauritius, the Netherlands and Uganda in 2003.

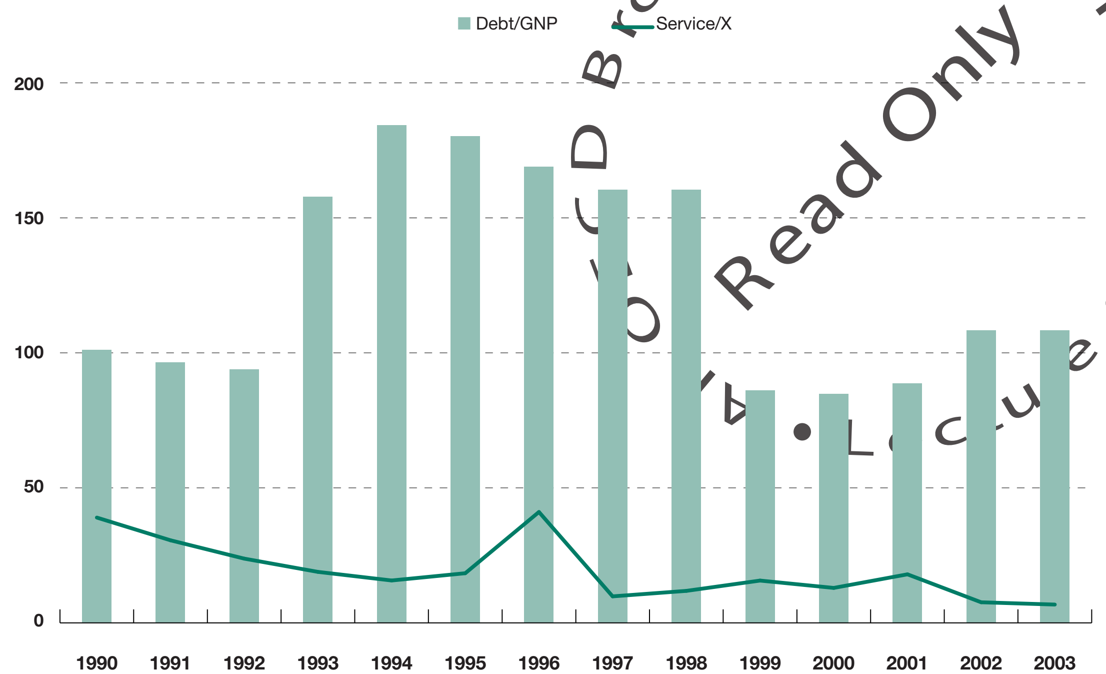
In April 2004, Ethiopia reached the completion point under the enhanced HIPC initiative, which is estimated to reduce Ethiopia's external debt service by approximately $3.3 billion in nominal terms. Total assistance under the HIPC initiative is estimated to be equivalent to debt reduction in net present value (NPV) terms of $1.3 billion, agreed at the decision point, plus a topping-up of assistance in an amount equivalent to $700 million in NPV terms, approved at the completion point. The exceptional additional assistance under the topping-up framework has been granted to Ethiopia due to exogenous shocks that adversely affected its debt sustainability, raising the NPV of its debt-to-exports ratio at end-2002/03 substantially above the 150 per cent threshold established under the enhanced HIPC framework. Ethiopia is close to reaching bilateral agreements on HIPC debt relief with the United Kingdom and the United States. Negotiations are progressing well with other Paris Club creditors and have been initiated with most other bilateral and commercial creditors. Resources made available by debt relief under the HIPC initiative are being allocated to pro-poor expenditure programmes. In 2001/02 and 2002/03, poverty-targeted spending has increased by $259 million (3.3 per cent of GDP), substantially more than HIPC relief, reflecting the resumption of donor assistance and a reduction in military spending. The stock of domestic debt rose from 37.4 per cent of GDP in 2000/01 to 39.1 per cent of GDP in 2002/03, and is projected to increase to 41 per cent of GDP in 2003/04. Together with the World Bank and Debt Relief International (DRI), the government is currently preparing a strategy for reducing both external and domestic debt. Furthermore, in order to increase the effectiveness of aid, Ethiopia's donors are harmonising their assistance, using Ethiopia's SDPRP and shifting from project to budgetary assistance. It has also been recognised that per capita aid flows to Ethiopia of $13 per person are less than half the average for sub-

Table 3 - **Current Account** (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Trade balance	-12.2	-16.8	-20.4	-20.6	-23.2	-24.3	-24.2
Exports of goods (f.o.b.)	6.9	7.1	7.4	7.3	7.4	7.7	7.8
Imports of goods (f.o.b.)	-19.1	-23.9	-27.8	-27.9	-30.7	-32.1	-32.1
Services	2.2	2.1	2.5	2.9			
Factor income	-0.7	-0.9	-0.7	-0.8			
Current transfers	11.0	11.7	12.9	15.9			
Current account balance	**0.3**	**-3.9**	**-5.7**	**-2.7**			

Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

Saharan Africa.

Structural Issues

Although they stagnated somewhat during the border conflict with Eritrea, various legal and regulatory reforms have been initiated since December 2000, particularly involving agriculture and public services. Though actual progress remains slow in some areas, especially with regard to securing private land ownership, the revision of the investment code yielded benefits such as an increase in the number of bilateral investment treaties signed[2]. Progress has also been made in resolving some of the key bottlenecks that emerged following fiscal decentralisation. The ability to track poverty-reducing spending in the *woradas* (districts) has improved, the period for fiscal reporting from the *woradas* to the central government has been shortened and the fiscal discipline of the *woradas* has been strengthened. Based on Ethiopia's agriculture-led industrialisation strategy, a new extension system known as the Participatory Demonstration and Extension Training System (PADETS) has been put in place.

Considerable progress has been made in Ethiopia's financial sector. Ethiopia's financial system consists of commercial banks, micro-finance institutions (MFIs) and financial co-operatives. The commercial banks include three state-owned banks: the Commercial Bank of Ethiopia (CBE), the Construction and Business Bank (CBB) and the Development Bank of Ethiopia (DBE), as well as six private banks. While some private banks have up to about 30 branches, the CBE, with 72 branches, has a market share of about 70 per cent. Unlike public banks, which exclusively serve large enterprises, some private banks are also active in financing small and medium-sized enterprises. All three public banks are supposed to be restructured

2. Since 1994, investment licences have been issued to 8 000 investment projects with a combined capital of about $10 billion; of this total, 3 421 investment projects with an aggregate capital of about $5 billion have become operational.

and/or privatised. While the restructuring of the CBE is moving forward according to plan, there have been numerous delays with the privatisation of the CBB. The DBE has been re-capitalised five times, most recently in 2003. The 2003 re-capitalisation went hand-in-hand with a major restructuring, but further restructuring is needed in order to maintain the bank's long-term viability. Foreign banks have so far not been allowed to enter Ethiopia on the grounds that financial reform must come first. One major regulatory change in the banking sector, which came into effect in March 2004, allows Ethiopians residing outside Ethiopia, as well as foreigners of Ethiopian origin, to open Ethiopian bank accounts in foreign currency.

The government as well as Ethiopia's donors have recognised the importance of micro and small-enterprise (MSE) development, and several federal and regional MSE development agencies have been established. Various donors (including the African Development Bank, the European Union, Germany, the Netherlands, the United Nations Industrial Development Organisation – UNIDO, and the World Bank) are supporting the development of MSEs through the provision of a variety of business support services. The latest approach is to link MSEs to medium-sized and large enterprises in order to develop value chains. The number of MSEs nearly doubled from 1997 to 2003, with the increase being attributed to the improvement in the support provided by the government, donors, NGOs and private sector initiatives. As of 2003, it was estimated that there were about 1.2 million micro-enterprises and about 65 000 small enterprises active in Ethiopia. Of these MSEs, 47 per cent were active in manufacturing, 42 per cent in services and trade, 6 per cent in community and personal services, and 5 per cent in agriculture, construction and transportation[3]. Though MSEs account for 99 per cent of business establishments and about 90 per cent of total employment in the manufacturing sector, their share of manufacturing output is only about 50 per cent. In addition to a lack in entrepreneurship, which is partly due to traditional values and norms, the lack of sufficient financing for MSEs is considered to be the most severe

Micro-finance Regulations: Small Changes Can Have Large Impacts

Recognising the importance of financial services to stimulate productivity and economic self-reliance, the government, NGOs and donors took the initiative to introduce innovative micro-financial services in the late 1980s. The government subsequently issued a proclamation and other regulatory directives for licensing and supervision of MFIs. In June 1999, the Association of Ethiopian Microfinance Institutions (AEMFI) was established to provide training, research, performance monitoring and advocacy for its members. Due to the efforts and services provided by the AEMFI, micro-finance institutions became increasingly successful in providing micro-finance to the rural poor, but there remained a considerable gap in financing MSEs. Based on the advocacy of the AEMFI, private sector agencies and donors engaged in Ethiopia's private sector development, the government enacted in 2003 a variety of regulatory changes that made it easier for MFIs to finance MSEs, mainly by increasing the maximum loan amount and extending the maximum loan maturity. As of mid-2004, there were 23 MFIs, which – following the regulatory changes – had extended their customer base from financing exclusively poor individuals to the financing of MSEs. While preliminary, the experience thus far suggests that the financing of MSEs has not only contributed significantly to the development of MSEs, but has also made MFIs more profitable and thus more sustainable. It is anticipated that some of the current MFIs will develop into full-fledged rural banks in a couple of years, which will then also be able to finance medium-sized enterprises.

3. Data based on various surveys undertaken by the Central Statistical Authority (CSA) in 1997 and 2003, as well as data provided and collected during interviews with the Association of Ethiopian Microfinance Institutions, representatives of the Ethio-German Micro and Small Enterprise Development Programme, and the Ethiopian Chamber of Commerce in October 2004.

constraint on MSE development. The main source of capital for MSEs is personal savings or gifts/borrowing from relatives and friends. Nevertheless, considerable progress has been made during the last two years in the provision of financing for MSEs through micro-finance institutions (MFIs), thanks to regulatory changes enacted in 2003 (see box on previous page).

In 1994, the government had embarked on a privatisation programme and created the Ethiopian Privatisation Agency (EPA), but progress has slowed during the last few years. While 178 mostly small public enterprises were privatised by 1998, only 22 more were sold to the private sector by April 2002, and eight more by June 2004. Hence, of the 313 enterprises originally scheduled to be privatised by the end of fiscal year 2003/04, 105 remain in government hands, including most of the large enterprises. In 2003, the EPA commissioned a study (financed by the German co-operation agency GTZ) to identify the reasons for the slow progress of Ethiopia's privatisation programme. Non-negotiable prices, inadequacy of valuation skills and the requirement that the buyer retain the entire workforce were considered to be the key impediments. Furthermore, it became clear that co-ordination problems between the EPA and the Public Enterprise Supervisory Authority (PESA) impeded transactions, especially after the PESA had been given a new mandate in 2002 to negotiate joint ventures, management contracts and the leasing of public enterprises. Based on the GTZ-financed study and subsequent reviews, concrete suggestions have been made for an integrated programme for all institutions involved. The government is in the process of finalising a detailed action plan.

While infrastructure facilities such as roads, electricity, water and communication media are relatively well developed in Addis Ababa, the picture changes considerably in some of the rural areas. Hence, there is a highly uneven distribution in the provision of infrastructure facilities across Ethiopia. Overall, Ethiopia has only 15 per cent of its national road network paved and only about 5 per cent of the population has access to electricity. Owing to lack of resources and other priorities, however, there were no major changes in the provision of infrastructure during 2003/04. The government continues to control the energy and telecommunications sectors.

Ethiopia has also made significant progress in easing regulatory burdens. Based on a 2004 World Bank report[4] assessing the business climate around the globe, Ethiopia is among the top performers in sub-Saharan Africa (SSA). According to the evaluation criteria, it takes fewer procedures and fewer days to start a business in Ethiopia than in the average country of SSA. It also takes slightly fewer procedures and slightly fewer days to enforce contracts. The costs of starting a business and of enforcing contracts are also below those of the average SSA country. Ethiopia also fares better than the average SSA country in all five indicators that measure how difficult it is to hire and fire workers. Although about twice as many procedures are required to register a property in Ethiopia, it takes only 56 days (compared to the SSA average of 114 days) to register a property in Ethiopia. Other obstacles remain, however, including poor roads, low demand, low skill levels and limited access to credit.

Political and Social Context

Following the peace agreement signed in December 2000, Ethiopia has made significant progress in maintaining peace with Eritrea. After a withdrawal and demobilisation of the two countries' troops following the peace agreement and the independent Boundary Commission's judgement on the location of the border in April 2002, the physical demarcation of the border took place in May 2003. There is some opposition to the government's conciliatory attitude towards Eritrea, however, and the formal agreement on the border demarcation has yet to be ratified. In November 2004, Ethiopia presented to the international community a five-point plan to resolve the border crisis. Under the plan, Ethiopia agreed to implement the ruling of the

4. *Doing Business in 2004: Understanding Regulation*; available on the World Bank website.

Border Commission and to co-operate in the demarcation of the border.

Democratisation has advanced, including decentralisation of authority from the regional to the *woreda* (district) level. The government is also implementing the various components of judicial reform as specified in the SDPRP of 2002. Based on a comparison of the Transparency International's Corruption Perceptions Indices for 2003 and 2004, Ethiopia seems to have made no progress in reducing corruption. While the October 2004 report by Transparency International ranked Ethiopia 114th out of 146 countries[5], Ethiopia fares slightly better in the perception of corruption than other countries with similar levels of GDP per capita.

The UNDP 2004 has ranked Ethiopia 137th out of 144 countries in terms of the status, treatment and participation of women (as measured by the UNDP's gender-related development index – GDI). Compared to its ranking on the overall human development index (HDI), viz. 170th out of 177 countries, Ethiopia ranks marginally better on the GDI. Yet, as a USAID report of March 2004 points out, Ethiopian women are socially subordinated, cultural and religious customs support male over female rights, and sexual violence is widely accepted. The report also notes that gender roles are a major constraint in combating the spread of HIV/AIDS, as well as making progress in other areas, notably education, women's economic empowerment and women's political participation. With 7.8 per cent of seats in parliament held by women, Ethiopia ranks 127th (out of 163 countries) on this score. The proportion of females in total population fell from 50.4 per cent in 1990 to 49.8 per cent in 2003. While life expectancy decreased by about two years for both men and women over the last five years (due to HIV/AIDS), Ethiopian women live about two years longer than Ethiopian men.

With one of the lowest levels of GDP per capita in the world, amounting to $96 in 2003, poverty and even the threat of starvation remain high in Ethiopia, especially in rural areas. Though there are signs of improvement, the relatively high level of adult HIV/AIDS prevalence remains a heavy burden. While this level has decreased by one third (from 6.6 per cent in 2001 to 4.4 per cent in 2003), it is estimated that the percentage of orphans due to HIV/AIDS in total orphans will increase from the current 25.8 per cent to about 43 per cent in 2010, at which time the number of total orphans is projected to exceed 5 million.

Despite the recent drought, the government is making good progress in implementing the 2002 SDPRP, the overriding objective of which is to reduce poverty while maintaining macroeconomic stability. Ethiopia remains heavily dependent on external assistance, which will need to be increased significantly in order to reach the MDGs. In order to maintain Ethiopia's public debt sustainability, the increase in external assistance will need to be provided mostly in the form of grants.

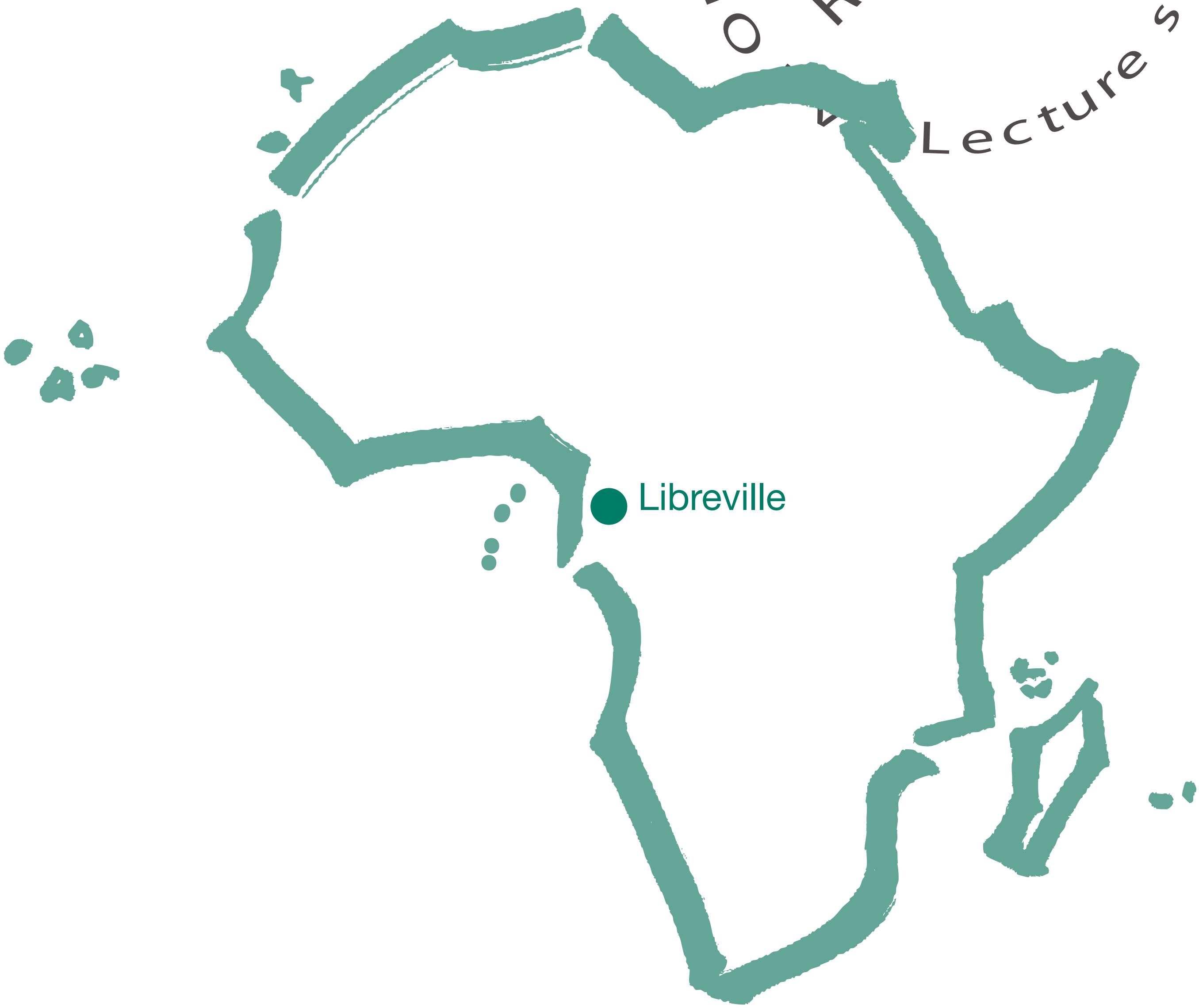
Some progress has been registered in health and education. The Ethiopian government's second Health Sector Development Programme (HSDP) was reviewed in 2003 and the government is moving ahead on several significant fronts, which include: implementing health sector reform; improving health management systems; implementation of health extension packages (HEP) to expand services to all rural communities; strengthening health products logistics systems; and combating malaria, tuberculosis and HIV/AIDS more actively. The government is currently also revising its population policy, emphasising immediate and sustained implementation of family planning programmes. In October 2004, the Disaster Prevention and Preparedness Commission launched a new programme that aims at providing some 5 million beneficiaries with a safety net. The programme, which is part of Ethiopia's five-year "New Coalition for Food and Livelihood Security", was scheduled to begin in early 2005. The project implementation manual has been prepared and will guide the implementation of the programme in selected drought-affected areas of Ethiopia. The five-year

5. Rank 114 is shared with the Republic of Congo, Honduras, Moldova, Sierra Leone, Uzbekistan, Venezuela and Zimbabwe.

programme carries a $3 billion price tag, and will involve multi-annual food aid and cash commitments as well as strategies aimed at reversing food aid dependency, a safety net programme with the provision of food or cash tied to beneficiary participation in public works and the improvement of agricultural technology in drought-prone areas.

Education, particularly primary education, has been identified as a national priority and increased expenditure earmarked for primary education. Ethiopia is in the midst of its second Education Sector Development Programme (ESDP) with the goal of achieving universal primary education by 2015. The education strategy emphasises decentralisation, community participation, cost sharing mechanisms (at secondary and tertiary levels) and the involvement of the private sector. In March 2003, the government launched a School Net and Woreda Net Initiative with the objective of improving the quality of and access to secondary and higher education. The Initiative also aims at improving communication and co-ordination among different

Gabon



key figures

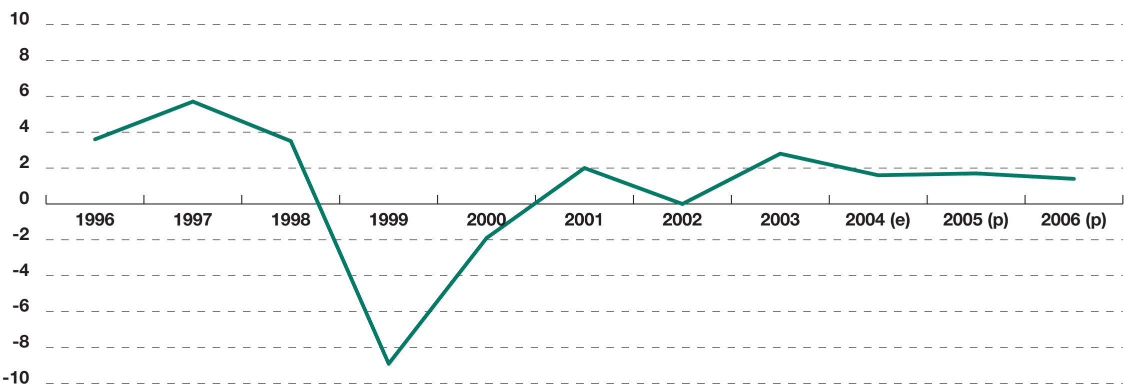
• Land area, thousands of km²	268
• Population, thousands (2004)	1 351
• GDP per capita, \$ (2003)	4 566
• Life expectancy (2000-2005)	56.6
• Illiteracy rate (2004)	...

IN MAY 2004, AFTER TWO YEARS of negotiations with the IMF and on completing its efforts to make structural adjustments and settle its external debt, Gabon obtained a 14-month stand-by agreement with the IMF. Domestic debt to the private sector piled up in 2002 and 2003, however, leading to a deterioration in companies' cash positions and to job losses in some sectors. During the same period, the non-oil sector, which is heavily dependent on public sector contracts, suffered from the absence of major state projects and a slowdown in donor activity. Oil production, reinvigorated by the very sharp increase in the price per barrel, rose 7.1 per cent in 2003 and stabilised (+0.7 per cent) in 2004 at 13.6 million tonnes instead of falling as expected. Unfortunately, this recovery has not reversed the downward trend in oil production in Gabon, as no substantial new deposits have been discovered. Household living standards, which are above the average for sub-Saharan Africa, have been falling, and as a result the government has made the fight against poverty one of its priorities and has begun drawing up a poverty reduction strategy paper.

Diversification of the economy is essential to compensate for reduced oil production.

The forestry sector is still in crisis owing to a variety of problems. Log exports fell again in early 2004, but timber processing held up well thanks to the positive impact of the new forestry code. Prospects looked more favourable in mining, with Brazilian and Chinese investors interested in working the country's manganese deposits. Comilog, the French subsidiary of Eramet Group, is also expected to increase its activity, encouraged by a rise in world prices. In the future, iron could also contribute to the diversification of the Gabonese economy.

Figure 1 - Real GDP Growth

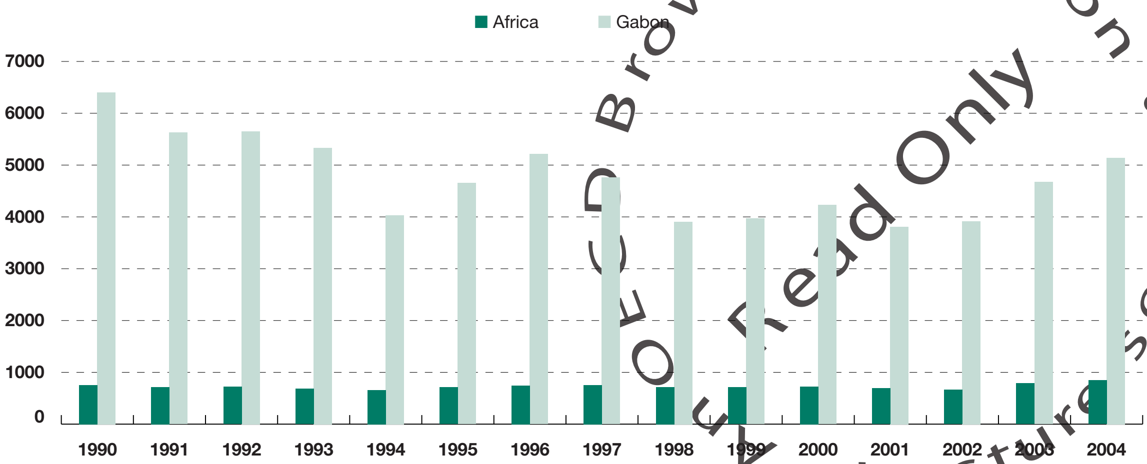


Source: *Direction Générale de l'Economie* data; estimates (e) and projections (p) based on authors' calculations.

The private sector consists of 20 or so major companies belonging to European or other international groups and a majority of informal sector businesses belonging to non-Gabonese nationals from Central and West Africa. On the whole, its level of activity is low. The main constraints on its development are the small size of the local market, with only 1.3 million inhabitants; high factor costs, particularly for credit; and the critical shortage of infrastructure.

Although all sectors of the economy suffered from the deterioration in public finances and longer delays in government payments, the real GDP growth rate excluding oil is estimated to have reached 2.3 per cent

Figure 2 - **GDP Per Capita in Gabon and in Africa** (current $)



Source: IMF.

in 2004, driven by a pick-up in public investment. The overall annual GDP growth rate of 1.6 per cent is still less than the annual rate of population growth, which is estimated at 1.9 per cent for the 2002-05 period. Within our forecasting period, the government should reactivate its plans to build social housing in partnership with Morocco. Each country is to finance 2 000 housing units, which would stimulate the construction sector. The economy is projected to grow by 1.7 per cent in 2005 and 1.4 per cent in 2006.

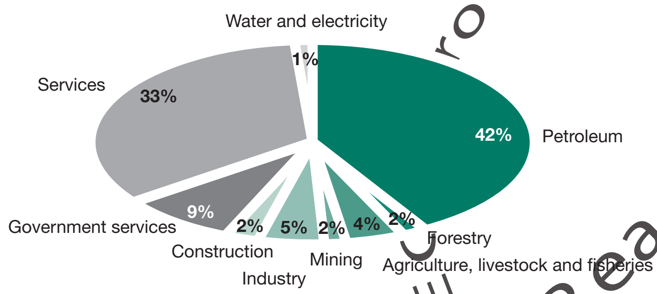
Recent Economic Developments

One of the first oil-producing countries in sub-Saharan Africa, Gabon was the third largest producer in the region in 2003, after Nigeria and Angola[1]. Since the discovery of the Rabi oil field in 1989, however, no other field of similar size has been discovered, and production has started to decline from its 1997 high point of 18.5 million tonnes. The recent favourable movement in the price of Brent crude has stimulated investment in the sector, however, and made it possible to reactivate projects that had hitherto been considered unprofitable. In 2003, production increased 7 per cent to around 13.5 million tonnes, or 98.5 million barrels, as against the expected 97.6 million barrels. These results were due in particular to an improvement in recovery of residual oil from mature wells and to the start of production on new fields – Atora, Toucan, Etame and Gombé Sud – over the last two years. Some exploratory wells drilled in 2003 yielded further discoveries, not yet brought on stream, that slightly increase the country's proven reserves but are not large enough to reverse the downward production trend. Three new production-sharing contracts were signed in 2003. In 2004, oil production again increased slightly and should total 13.6 million tonnes, as against the expected 13.3 million tonnes.

Forests cover three-quarters of Gabon's territory and were the leading source of public revenue prior to the start of oil production. The timber industry has been identified by the government as a sector offering high potential in the post-oil era. The implementation of a new forestry code, designed on the one hand to develop sustainable management programmes[2] and on the other to encourage domestic timber processing[3] through the introduction of tax incentives, was at first an obstacle to investment and forest management projects. Firms

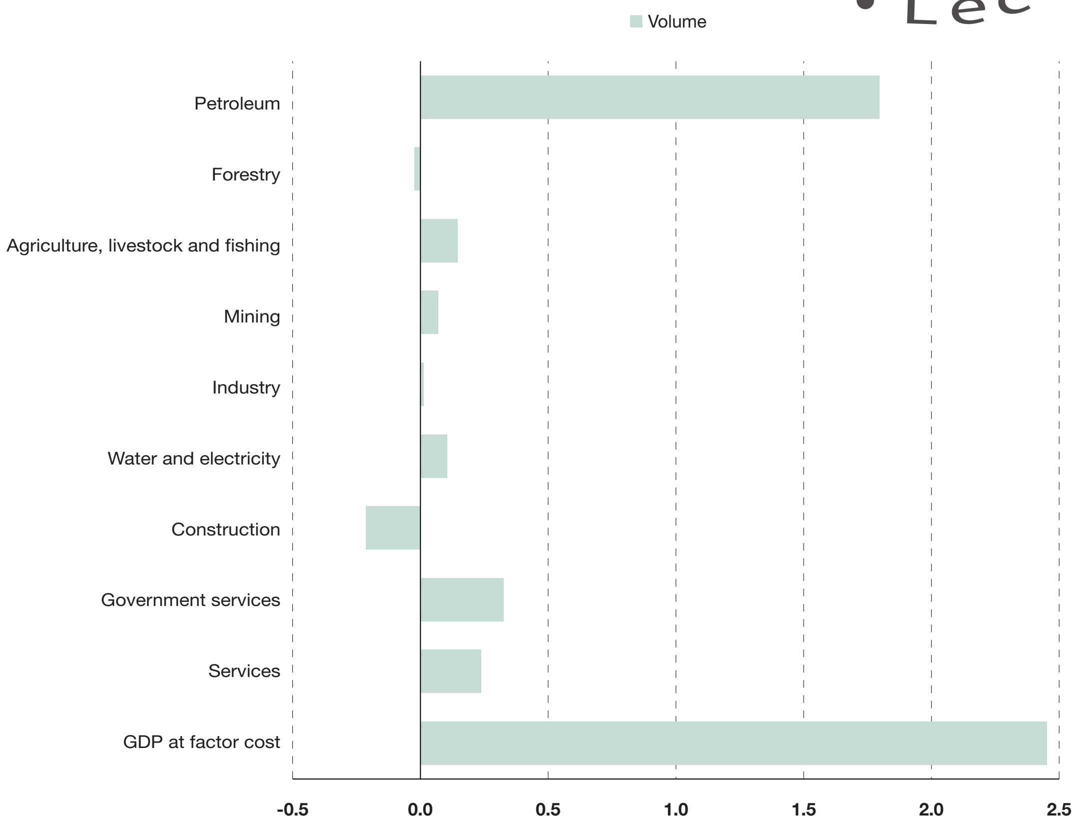
1. It was due to be overtaken by Equatorial Guinea in 2004.
2. At the end of a four-year transitional period, all logging permits will have to comply with the new law by 1 January 2006.
2. The law's declared objective is to have 75 per cent of log production processed domestically by 2012. This level is currently estimated at 30 per cent.

Figure 3 - **GDP by Sector in 2003** (percentage)



Note: The oil sector comprises crude oil production, refining, exploration and oil services.
Source: Authors' estimates based on *Direction Générale de l'Economie* data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



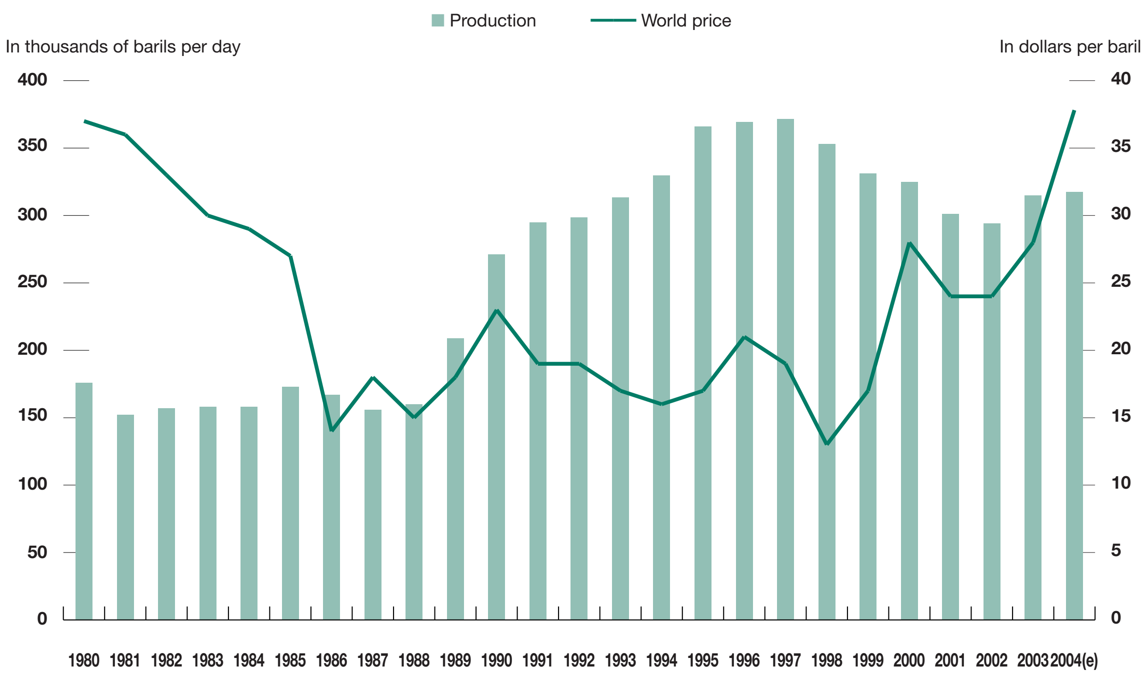
Source: Authors' estimates based on *Direction Générale de l'Economie* data.

had difficulty, notably, in finding enough unoccupied land to use the rotation system featured in the management plans. Others had their harvestable area reduced by the creation of 13 national parks, apparently without receiving any compensation. Lastly, as the purpose of the current reforms is to create transparent conditions for the harvesting of forest resources by providing for the sale of permits by adjudication, as opposed to the current practice of person-to-person transactions, the Water and Forestry Department was confronted with the difficulty of estimating the real value of timber resources by area of adjudication, which is holding back the development and implementation of a real sectoral strategy. The reform provoked acute social tension, and some timber firms laid off workers in late 2003 and early 2004 in response to the deterioration of their financial situations.

Production of okume, the main harvestable species among the 400 trees and bushes found in Gabon, continued to fall in 2004 owing to shipping constraints, stiffer competition from neighbouring countries and the policy of local timber processing. In the first half of 2004, total timber exports fell a further 13 per cent year-on-year, but this fall did not affect all varieties in the same fashion. Exports of the traditional varieties of okume and ozigo fell 28.3 and 91.7 per cent respectively during this period, while exports of "mixed timber" increased substantially, rising 13.2 per cent year-on-year during the first half of 2004 owing to strong Asian demand for high-quality timber. On an unfavourable international market, the competitiveness of Gabon's forestry industry was constrained by keener competition from Asian timber, depreciation of the US dollar and the industry's internal problems, which included higher freight costs, a tax burden which was judged excessive and the unattractive producer prices offered by the Société Nationale de Bois du Gabon (SNBG). To ensure that the reforms essential to the sector's development are continued, an action plan aimed at gradual elimination of the SNBG's marketing monopoly[4] was adopted in December 2003.

In the primary sector, Gabon has very high mining potential which could contribute more to the diversification of its economy. It is the world's second largest producer of manganese after South Africa, thanks to the Moanda deposit worked by the Compagnie Minière de l'Ogooué (Comilog), a subsidiary of Eramet. In the first half of 2004, manganese production, boosted by demand from China, rose to 1.2 million tonnes, an increase of 30 per cent over the same period in 2003. The country is also rich in gold and diamonds. A number of projects in progress and visits by several foreign delegations, notably from Asia, should improve prospects for investment in this sector. Gabon's iron resources, which have never been mined despite their excellent quality, hold real potential for the economy.

Figure 5 - **Oil Production and Prices in Gabon**



Source: Energy Information Administration, *Direction Générale de l'Economie* (production) and OECD (international price).

4. It has been decided that SNGB will lose its monopoly on the marketing of okume and ozigo in January 2006.

The government is currently considering the possibility of mining the Belinga deposit, which has proven reserves of approximately 640 million tonnes and has attracted the interest of Chinese investors. Agriculture, livestock and fishing are very little developed in Gabon, generating only 4 per cent of GDP in 2003, despite soil quality comparable to that of neighbouring Cameroon.

In the secondary sector, the crisis in the construction industry continued with a 15 per cent fall in activity in 2003, principally as a result of a slowdown in building caused by an accumulation of government payment arrears to suppliers, which reached a total of 180 billion CFA francs, and the low level of public investment. Activity in the sector started to recover in the first half of 2004, however, when production rose 8.6 per cent thanks to the resumption of roadwork and construction of some buildings. Sales of construction materials picked up, as indicated by the 8.4 per cent increase in cement production end-June 2004. At the same time, exports of cement skyrocketed (+112.9 per cent) in response to brisk demand from Equatorial Guinea.

Power and water production, which is the responsibility of the Société d'Electricité et d'Eau du Gabon (SEEG), increased by 5 per cent in 2003 over the preceding year. Although its turnover grew by nearly 7 per cent, SEEG also suffered from the delays in government payments and was able to finance only 20 billion CFA francs' worth of construction work to increase production capacity, extend its distribution network, modernise its operations and replace plant and equipment, compared with 30 billion CFA francs in 2002. In the first half of 2004, the electricity sector continued to grow with a 1.7 per cent increase in net output. Net water production increased by 6.4 per cent, slightly less than the 6.9 per cent increase in turnover.

The tertiary sector, comprising commercial and public sector services, accounts for 42 per cent of GDP and should show growth of around 1.3 per cent in 2004. Within this sector, the telecommunications network was opened up to mobile telephone service with the arrival of Libertis, Celtel and Telecel, which are overseen by the telecommunications regulation agency ARTEL. Modernisation of the sector has continued recently following the "official" connection in May 2002 to the SAT3 submarine fibre-optic cable linking Africa and Europe. Gabon also has access to a broadband Internet network and, according to a recent ARTEL study, possesses a stock of some 25 000 micro-computers, or one for every 50 inhabitants. Despite the morose economic situation, the number of subscribers increased from 255 000 to 336 000 for the three operators together, which represents an increase of about 32 per cent in 2003. At the same time, the improvement of fixed telephone services remains an important challenge since this is a preferred tool of businesses. The latter continue to suffer from long connection delays and especially from prices that are extremely high compared to those in the rest of the sub-region, particularly for international calls. In this context, the privatisation of Gabon Télécom recommended by the IMF should take place during the first quarter of 2005.

The Societe d'Exploitation du Transgabonais (Setrag) has been running the national railway on behalf of the state since May 2003. Revenues have been falling steadily despite a price increase in May 2003. The volume of freight transported increased slightly in 2003 to 3 million tonnes from 2.9 million tonnes in 2002. Transportation of sawn timber showed strong growth (+40 per cent), while that of manganese ore rose to a lesser extent from 1.7 million tonnes in 2001 to 1.8 million in 2002 and 1.9 million in 2003. Log and oil traffic registered marked reductions in volume (-11 and about -15 respectively) in 2003. In the first half of 2004, rail transport activity improved. Overall freight volume rose 23.5 per cent, while that of sawn timber and manganese showed increases of 40 and 32.7 per cent respectively. The number of passengers also increased by about 15 per cent during the celebrations of Gabon's independence, known as "rotating festivals" because they are held each year in different provinces in the interior of the country.

Port activities slowed as a result of the fall in imports of containerised goods. The port of Libreville was badly affected, seeing its traffic fall by 10 per cent from 2002 to 2003, whereas traffic in Port Gentil rose 11 per cent owing to the oil exploration and production programme initiated in 2002. On the export side, containerised goods showed strong growth in 2003 – 12 per cent at Libreville and 65 per cent at Port Gentil – thanks to buoyant sales of processed timber. Air transport suffered from the slump in domestic passenger traffic. During the first half of 2004, domestic and international air transport, measured by number of passengers and aircraft movements, fell by 11.2 and 15.8 per cent respectively year-on-year, despite Air Gabon's ambitions to become an African hub.

New vehicle sales stagnated in 2003 at 2 950, compared with 2 938 in 2002, and were increasingly accounted for by two main customers, Gabon Télécom and the state. This relatively small sector suffered from the diminution of the public investment budget and the accumulation of payment arrears. It was also adversely affected by slowness in registering vehicles and issuing registration documentation, for which there is sometimes a wait of six months. Sales of commercial vehicles continued to fall. In the first half of 2004, sales dropped by 11.6 per cent compared with the same period in 2003, although there was a slight pickup (+13.4 per cent) in sales of industrial vehicles.

The hotel market, which is primarily geared towards business customers, is having difficulty in attracting the tourist trade. Hotel occupancy, which stands at an average of 50 per cent for the three main hotels in Libreville, was down 3 per cent in first half of 2004 year-on-year, reflecting the poor business climate. In addition, as three big hotels – the Meridien, the Intercontinental and the Novotel – are still publicly owned, this sector also suffered from the government's payments difficulties.

Oil production in 2004 was virtually stable (up

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**20.0**	**30.4**	**31.6**	**29.7**	**29.5**	**31.8**	**37.0**
Public	5.3	7.0	6.8	7.0	6.7	6.8	7.3
Private	14.7	23.5	24.8	22.7	22.8	25.1	29.7
Consumption	**54.3**	**50.8**	**52.2**	**51.7**	**46.8**	**44.6**	**45.8**
Public	11.2	15.5	15.1	14.3	13.0	12.3	12.5
Private	43.0	35.3	37.0	37.4	33.8	32.3	33.3
External sector	**25.8**	**18.8**	**16.2**	**18.6**	**23.7**	**23.6**	**17.2**
Exports	60.9	57.4	55.5	56.0	59.3	59.2	54.4
Imports	-35.1	-38.7	-39.2	-37.4	-35.7	-35.5	-37.2

Source: *Direction Générale de l'Economie* and IMF data; estimates (e) and projections (p) based on authors' calculations.

0.7 per cent) after the jump recorded in 2003 as a result of the improvement in oil recovery rates. Consumption was flat owing to the sluggishness of the economy and the fall in incomes, particularly in the timber sector. In addition, after several years of growth, oil sector investments began to drop. There is some reason, however, for thinking that the Gabonese economy is starting to diversify. First, iron and manganese mining projects should get underway within the period covered by our forecasts, and investments are also planned in the energy sector. In addition, the approval of a programme with the IMF and the gradual rollback of domestic debt should improve economic visibility and restore business confidence by re-establishing liquidity levels. On 24 March 2004, a transfer of 38.9 billion CFA francs was made to the Libreville Club in settlement of the first tranche of domestic public debt.

Macroeconomic Policies

Fiscal and Monetary Policy

As a member of the Central African Economic and Monetary Community (CEMAC), Gabon must meet certain convergence criteria. In 2004, it complied with all these criteria, which relate to its basic budgetary balance, inflation, public debt levels and the absence of payment arrears. This performance marks an improvement over 2003, when the criterion on arrears was not met.

After failing to complete two programmes – a stand-by agreement in 2000 and an extended fund facility in 1995 – Gabon obtained in May 2004, after two years of negotiations, a 14-month stand-by agreement with the IMF in the amount of 69.44 million SDR (45 per cent of quota), to be paid in five instalments of 13.89 million SDR. The aim of this programme is to promote the growth of the non-oil sector through appropriate structural reforms, to support budgetary adjustment and to improve management of public spending.

Gabon's public finances are characterised by the dominant position of the oil sector, which accounts for more than half of revenues, a low level of investment spending and a heavy debt service burden (interest and repayment of principal) that absorbs about a third of public revenue. In this context, the low tax ratio is problematic, especially since a fall in the apparent tax ratio has been observed recently in the oil sector. This situation shows the urgency of the need to diversify the state's tax base, increase non-oil revenues and stimulate investment so as to make the debt burden sustainable.

Budget performance in 2004 was marked by a 10 per cent increase in revenues, including grants, and a contained spending increase of 4 per cent. The improvement in revenues was primarily due to the small increase in oil production, which raised public oil revenues to 640 billion CFA francs ($1.2 billion), up 12 per cent, while non-oil revenues increased by 7 per cent. The apparent tax ratio in the oil sector fell between 2000 and 2004, however, owing to the fall in oil production at the beginning of the year, the low level of adjustments for the 2003 fiscal year and, above all, the increased cost of extracting oil from mature fields.

Budget spending continues to be marked by the predominance of current expenditure, which accounts for 74 per cent of total expenditure and remained virtually stable in 2004. The year also saw a 3 per cent increase in spending on transfers and interventions and a very sharp 24.3 per cent surge in capital expenditure. At 3.6 per cent of GDP, however, the investment budget remains structurally low with respect to the country's long-term infrastructure needs, and this cannot be sustained over the long term. The overall budget balance, which is generally in surplus, will rise to 8.8 per cent of GDP compared to 7.4 per cent in 2003.

Table 2 - Public Finances (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**25.9**	**34.0**	**31.7**	**29.8**	**29.7**	**29.7**	**28.3**
Tax revenue	9.3	11.2	12.4	12.3	11.8	11.8	12.1
Oil revenue	15.4	21.8	17.7	16.2	16.3	16.5	14.8
Total expenditure and net lending[a]	**23.7**	**30.7**	**28.2**	**22.4**	**20.9**	**19.2**	**19.5**
Current expenditure	18.4	24.9	23.7	18.7	17.3	15.6	15.7
Excluding interest	*12.0*	*16.1*	*19.3*	*14.7*	*13.4*	*12.7*	*12.9*
Wages and salaries	6.3	6.4	6.4	6.5	5.8	5.4	5.4
Interest	6.4	8.8	4.4	4.0	3.9	2.9	2.7
Capital expenditure	5.3	4.7	4.0	3.7	3.6	3.6	3.9
Primary balance	**8.6**	**12.0**	**7.9**	**11.4**	**12.7**	**13.5**	**11.5**
Overall balance	**2.3**	**3.2**	**3.5**	**7.4**	**8.8**	**10.5**	**8.7**

a. Only major items are reported.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

The budget bill for 2005, a presidential election year, was adopted in October 2004. It is based on the hypothesis of 2.4 per cent growth in GDP and a 28.7 per cent increase in oil revenue. Revenue and expenditure balance out at 1 184.2 billion CFA francs, a lower figure than in the 2004 budget. The debt restructuring granted in 2004 by the Paris Club reduced the debt

Oil Taxation, or Why Oil Revenue Fell in 2003 When the Price per Barrel Was Soaring

Public oil revenues in Gabon are derived mainly from the proportional mining fee, company tax, revenues from operating and production-sharing contracts, and dividends. In the past, falls in revenue have naturally been mainly attributable to lower production and falling oil prices. In 2003, however, although production volume increased by 7 per cent to 13.5 million tonnes owing to an improved recovery rate and although the price per barrel soared, total revenues fell 6.4 per cent, from 609 billion CFA francs ($877.4 million) in 2002 to 570.2 billion CFA francs ($983.3 million) in 2003. This apparently paradoxical decline may be attributed to several factors:

- the depreciation of the dollar, which was on the same scale in 2003 as the increase in the price of a barrel of oil on the international market, led to reduced fiscal revenues in local currency;
- an increase in the quality markdown, which has risen by 60 per cent – from an average $0.63 to $0.99 in 2003 – as the main Gabonese oil fields have reached maturity;
- the increasing impact of operating and production-sharing contracts on oil taxation[5], as this practice leads to a reduction in the permit fee[6] to attract oil companies and a reduction in company tax;
- the scale of the investments made to maintain production on mature fields, which require cost recovery mechanisms that can have a negative impact on revenues.

It would seem, then, that in Gabon the apparent tax ratio moves in the opposite direction from world prices.

service burden in the 2005 budget, but this debt relief has benefited current spending, which will rise from 31 per cent of budget expenditure in 2004 to 41 per cent in 2005, more than investment spending. Despite the government's priorities in favour of housing, education, social affairs, agriculture and the family, investment will account for only 14 per cent of budget expenditure in 2005, compared with 11 per cent in 2004. The education budget, however, will increase 45 per cent in 2005 to 68 billion CFA francs ($134.4 million), of which 8 billion CFA francs ($15.8 million) will be devoted to investment.

As regards the government's domestic arrears, an agreement was reached in April 2004 with a group of domestic creditors known as the Libreville Club. This group is open to all creditors with claims exceeding 50 million CFA francs ($94 500) and maturing in less than 18 months. Claims submitted to the Libreville Club amount to 38.9 billion CFA francs ($73.5 million). The repayment plan provides for payments of 2.2 billion CFA francs ($4.2 million) per month on arrears totalling 21.2 billion CFA francs ($36.6 million) at the end of 2003, bringing the total down to 5.5 billion CFA francs ($10.4 million) by the end of June 2004. The Treasury now undertakes to meet all claims for payment within 120 days. This commitment constitutes a real advance which should be welcome to businesses, as their credibility with the banking system has been seriously compromised. From 2005, surplus oil revenues are to be used to retire domestic debt more quickly, with the remainder going into a fund for future generations. At this pace, according to the IMF, all domestic public debt will be eliminated by 2013, as its maturity is generally

5. When it grants a concession, the state receives royalties and, in theory, levies a 73 per cent tax on corporate profits (a level unchanged since 1999). For production-sharing contracts, the state receives royalties but subsequently receives a share of the sales proportional to its stake in the project. Giving up the profits tax for a share of production is the price to be paid for encouraging new investment.

6. Whereas concession contracts provide for non-renegotiable royalty rates ranging from 10 to 20 per cent, under operating and production-sharing contracts the rates ranged from 0 to 20 per cent in 1999 and were reduced to 0 to 15 per cent in 2003

short term.

Like the other CEMAC countries, Gabon has a fixed exchange rate with respect to the euro and its monitory policy is directed by the Bank of Central African States (BEAC), which leaves it with budgetary policy as its principal policy tool. Inflation, after rising 2.1 per cent in 2003, fell slightly to an annual average of 1.5 per cent in 2004 owing to the dollar's depreciation against the euro and a fall in the price of local products, notably food. In 2005 and 2006, inflation is expected to climb back to 2.5 per cent, fuelled by the further increase in oil prices.

External Position

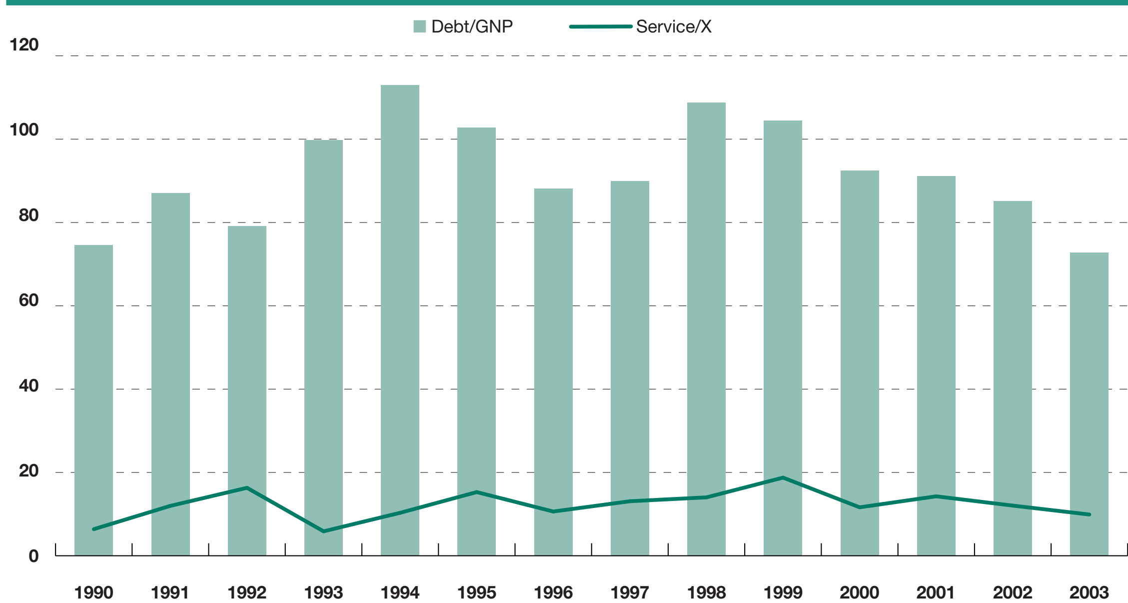
In 2004, the trade balance showed a surplus of 1 502.4 billion CFA francs ($2 835.5 million), representing a coverage level of 260 per cent. This result was due to a 28 per cent increase in the value of exports, itself resulting mainly from a 25 per cent increase in oil sales over 2003. In the first half of 2004, timber sales were up 10 per cent over 2003. This recovery is attributable to an increase in exports of processed timber and furniture, in accordance with the sectoral industrialisation policy. Export sales of logs also increased 6 per cent over the same period. Imports in 2004 rose by 11.5 per cent over 2003 as a result of a general price increase for all categories of imported

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	39.0	37.5	33.2	35.6	39.6	39.3	33.9
Exports of goods (f.o.b.)	56.0	55.5	52.6	53.5	57.2	57.2	52.3
Imports of goods (f.o.b.)	-17.0	-18.0	-19.3	-17.9	-17.6	-17.9	-18.5
Services	-19.7	-17.2	-22.9	-21.3			
Factor income	-5.7	-7.6	-3.5	-3.2			
Current transfers	-3.2	-1.7	-1.7	-1.5			
Current account balance	**10.4**	**11.0**	**5.2**	**9.6**			

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 6 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

products, particularly capital equipment. At the same time, Gabon saw an increase in imports of low-quality products and an increase in import fraud which damaged its competitiveness.

Overall, external trade, which is in structural surplus in Gabon, is dominated by oil (which accounted for 80 per cent of exports in 2003), tropical timber (11 per cent) and manganese (5 per cent). The country's main customer is the United States, which absorbed 75 per cent of Gabon's exports, mainly in the form of oil. Its principal supplier is France, which, despite some erosion of its position, still accounts for a third of the import market.

As part of the stand-by agreement granted by the IMF, the Paris Club rescheduled 717 million euros of Gabon's debt in June 2004. This sum comprises arrears totalling 456 million euros and 261 million euros in payments falling due between 1 May 2004 and 30 June 2005. The rescheduling reduces debt service due to the Paris Club over the period from 953 million euros to 270 million euros, or 28.3 per cent of its initial level. Towards the end of 2005, the Paris Club may consider another rescheduling operation on Gabon's debt under a further agreement with the IMF, with the principal aim of reducing domestic debt and thus helping to revive private investment, which is necessary for successful diversification of the economy. This agreement will also help to make Gabon's public debt sustainable in the short term, as the new scenario indicates that public debt and external debt will fall steadily as a percentage of GDP in the medium term. Since priority will be given from 2005 to retiring domestic debt, the external debt ratio will fall less quickly than that of total debt.

Structural Issues

Gabon still needs to make a great deal of progress with respect to privatisation outside the banking and energy sectors, as well as in the modernisation of infrastructure, particularly roads, in the interior. The development of the private sector is severely hampered by these structural constraints, as well as by the difficulties of small and medium-sized enterprises in obtaining bank credit and by high transaction costs which detract from the country's competitiveness. Oil apart, the mining sector offers good prospects in Gabon but its potential remains to be explored.

The business environment is reasonably reassuring for investors, thanks to Gabon's political stability and its central geographical position on the Gulf of Guinea and in Central Africa. The country also boasts a modern banking system. Business law has been revised in line with the principles of the Organisation for Harmonisation of Business Law in Africa (OHADA), and the tax situation is relatively attractive with company tax at 35 per cent. As a result of a VAT revision in 2003, however, there are now several VAT rates, contrary to good international practice. The country's key problem is that the government, which is the main customer of private sector firms, puts their liquidity at enormous risk in times of crisis. In addition, businesses have been complaining in recent years of the lack of visibility in the economy in the absence of a clear macroeconomic framework and major projects.

With five commercial banks, a development bank and six specialised credit institutions, Gabon has a modern banking network. The sector suffered in 2003 from the crisis in the timber, mining and construction sectors, with the result that its overall activity fell and the quality of loan portfolios declined. This slowdown continued in the first half of 2004 with a fall in the stock of deposits collected, outstanding loans and the profitability of net capital stock. Fixed-term savings deposits fell in favour of demand deposits, reducing banks' available resources by nearly three percentage points. The percentage of loans covered by deposits rose by eight points – from 127.7 per cent in the first half of 2003 to 134.8 per cent in the first half of 2004 – but this improvement masks the fact that new loan applications fell in relation to deposits, as a result of banks' strong reticence about granting loans combined with a lack of eligible projects. Over the same period, banks' return on capital fell six points to 12.7 per cent in June 2004, compared with 19 per cent in June 2003. The banking sector, which was deeply affected by the crisis it went through in the 1990s, lends very little to small and medium-sized enterprises (SMEs).

It is difficult to ascertain the precise number of SMEs in Gabon. The official definition in law 1/81, which is based on investment level, currently applies to virtually all businesses in Gabon. The Ministry for SMEs considers, however, that there are about 4 000 firms in this category, as well as 6 000 to 9 000 small trading businesses and other small units in the informal sector. Generally speaking, businesses in Gabon fall into three categories. First, there are some 20 major companies, which are well structured and have regular legal status. Most of these are subsidiaries of major European or other international groups, operating mainly in sectors such as construction, transport, import-export and services (banking and insurance). By virtue of their links to multinational groups, they can withstand crises and obtain financing from local banks. Second, there are some medium-sized companies, mainly in retailing (pharmacies, commerce and book shops), hotels, restaurants and services (private schools and laundries). Their value added is low and their lifespans highly variable. There are too few of these companies to form an economic fabric of the density required by the Gabonese economy, and they have difficulty obtaining loans. This category also includes some "opportunistic" companies that are formed in response to public contracts and disappear as soon as the work has been completed. Third, there are many small enterprises in the informal sector, run by West Africans or nationals from other Central African countries. In most cases, small informal sector enterprises are created by individual entrepreneurs, who conduct their businesses without accounts, capital or registration. Their turnover is small, and they cannot obtain loans from financial institutions, which regard them as lacking in credibility.

All SMEs face many obstacles which hamper their development. One of the principal barriers is the small size of the local market, with a population of only 1 351 000. According to the Agency for Promotion of Private Investment (APIP), however, there are opportunities for expansion, notably in timber processing, fish farming, fishing and agriculture. Although Gabon enjoys favourable conditions for agriculture, this sector is virtually undeveloped[7], leaving the country heavily dependent on food imports from neighbouring Cameroon. Many observers have pointed to an absence of entrepreneurial spirit as a factor holding back private sector development in Gabon, where the state has always been the leading employer and where young people start preparing for civil service careers while still in school, because of a lack of suitable training facilities such as business and management schools.

Most Gabonese banks have not forgotten the low level of loan recovery from SMEs that led to the severe crisis suffered by the banking sector in the 1980s, and this does not facilitate such firms' access to credit. The financing of small businesses is handicapped by the lack of appropriate institutions and by the high cost of credit. Organisations specifically devoted to assisting these firms – the Ministry for SMEs, PromoGabon, the SME development and expansion fund (FODEX), the SME assistance and guarantee fund (FAGA), APIP and others – are poorly co-ordinated and inefficient. Since the withdrawal of the African Development Bank, FODEX, which is a public fund under the authority of the prime minister, has only its own funds to work with, and its loan recovery ratio is mediocre. New statutes are being prepared for FODEX for early 2005 to make it more effective in financing SMEs by refocusing its activities on micro-credit. PromoGabon, a business promotion body under the authority of the Ministry for SMEs, has few resources and helps barely 30 businesses per year with their start-up procedures. FAGA hardly exists any more, and APIP, with just one reception point, registers companies but provides no follow-up or support.

In October 2004, after several failed attempts and postponements, declarations of interest were invited for the sale of a 51 per cent stake, as opposed to 35 per cent initially, in Gabon Télécom, which is wholly owned by the state. The privatisation of this major company, which employs more than 2 000 people, has proved to be a sensitive matter but should be carried out during the first half of 2005. A deadlock over privatisation was finally broken by agreements on employment issues and

7. Cereals production in Gabon in 2003, for example, was one-third of the average for the five preceding years, according to the FAO.

The Ministry of Finance Wants to Promote Micro-financing, which is still Undeveloped in Gabon

Owing to the inefficiency of the existing system, the Ministry for SMEs is undergoing a major restructuring. A bill aimed at clarifying the status of SMEs is to be introduced in early 2005. With SMEs clearly divided into four categories by turnover and investment level, the ministry will be better able to define its own new programme, which is designed to help the smallest companies get over the barrier between the informal and formal sectors. The ministry is also making use of external experts such as Planète Finances to set up more appropriate aid structures. At present, micro-financing is still little developed in Gabon, where 0.25 per cent of the population has access to micro-finance institutions, compared to 4 per cent in Cameroon. The Financial Bank, which specialises in micro-financing, is currently studying the feasibility of micro-projects so as to propose a range of services meeting the needs of very small companies. Solutions such as business "incubators"[8] could be another possibility to explore.

In addition, a national unit for the promotion of micro-financing was set up by the Ministry of Finance in December 2003, as was an association of micro-financing institutions, the APEMFG. In July 2004, the micro-financing unit conducted a campaign to raise awareness about micro-financing and explain how it works. The unit is supposed to draw up an operational strategy for the development of this activity, but in 2005 the emphasis will be more on the search for funding, in the form of a line of credit from donors for

the procedure for registering land rights and property holdings. Some 450 people will be made redundant at a total cost of 11.8 billion CFA francs ($22.3 million). In contrast, the division of the Office Public de Telecommunications into two entities, Gabon Poste and Gabon Télécom, and the creation of regulatory bodies have been completed, and the new entities have been in operation since early 2002.

In the transport sector, the privatisation committee, which is the adjudicating body, issued a call for expressions of interest in the partial privatisation of the national airline, Air Gabon. Since 2002, the state has been the company's sole shareholder. Air France had a 20 per cent stake but decided not to join the state in assuming the liabilities of Air Gabon, totalling some 60 billion CFA francs, on 31 December 2001. Efforts were made in 2003 to improve operating results, with technical assistance from Lufthansa Consulting. The creation of a regional airline has often been presented as the preferred framework for the future privatisation of Air Gabon, scheduled for 2006. This idea became a reality following the partnership agreement concluded in Libreville on 3 December 2004 between two other CEMAC countries and Royal Air Maroc. The new airline should become operational during the first half of 2005. The management concession for the ports of Libreville and Port Gentil was awarded to the Spanish firm Sygeprag in September 2003 and came into effect in mid-2004. This company must undertake renovation work and manage the assets of the ports within the customs barrier. To this end, its business plan calls for investments totalling 18.2 billion CFA francs ($34.4 million) during its first ten years and 35.6 billion CFA francs ($67.3 million) for the 2014-18 period.

In the agricultural sector, the assets of AgroGabon, which mainly produces palm oil, and Hevegab, specialising in rubber, were sold in May 2004 to the Belgian group SIAT (Société d'Investissement pour l'Agriculture Tropicale) for 1 and 2 billion CFA francs ($1.9 and $3.8 million) respectively. The group also acquired the Nyanga cattle ranch, which belonged to Sogadel, for 720 million CFA francs ($1.3 million). A single company, SIAT Gabon, was set up, with its head office in Lambarène and a sales office in Libreville. The company is to invest 10 billion CFA francs ($18.9 million) over the next 18 months on

8. According to Pickard and Thormburgh, a business incubator is "a place where small businesses can start up and grow".

rehabilitation of its industrial assets and rolling stock and the construction of a meat processing plant.

Although Gabon is the wealthiest country in Central Africa, its road infrastructure is in very poor condition; in fact, road density and the level of paved road per capita are among the lowest in sub-Saharan Africa. Out of a total of 9 170 km of roads in Gabon, only 936 km are paved. A further 7 600 km are laid with laterite and 630 km are dirt tracks. The road network improvement programme launched in 1992 aimed to make up the shortfall in two phases over five years at a cost of 280 billion CFA francs ($529 million). Execution of the programme has been rather poor, with only 519 km of roads – 27 per cent of the initial programme – paved between 1993 and 2001. Work was due to start up again under a World Bank project, but the country's needs remain enormous. In addition to the lag in road investment, the road maintenance fund, set up in 1997, has run into difficulties over its supply of funding and the performance of its tasks.

Gabon's mineral wealth is not limited to oil. Uranium was mined for many years by the firm Comuf, until the deposit was exhausted and, through Comilog, the country is today the world's second largest producer of manganese. Gabon's principal manganese mine at Moanda is operated by Comilog. The deposit is of very good quality with a 50 per cent ore content. In 2004, the Compagnie Minière des Trois Rivières (CMTR), a subsidiary of Brazil's Companhia Vale do Rio (CRVD), obtained two permits to prospect for manganese at Okondja and Franceville. For the time being, work is limited to evaluation of reserves, but prospects for a production start-up in 2005 are promising. The terms of the concession contract between the company and the Gabonese government have yet to be settled. The Chinese company Xuzhan has also expressed interesting in producing manganese in Gabon and has obtained authorisation to prospect in the Bembele Mountains near Ndjole.

The other ore offering strong potential and highly encouraging short- and medium-term prospects is iron. The biggest and most thoroughly explored deposit is at Belinga, where the ore is rich and resources are estimated at 640 million tonnes. In the same region, smaller deposits can be found at Boka-Boka (194 million tonnes), Baouala (117 million) and Minkebe (60 million). There has been some prospecting in the Milingui area, where proximity to the sea and the presence of offshore gas could facilitate the mining and marketing of ore. The government is even considering creating a port at Mayumba to remove the iron, as well as timber, barite, talc and marble, and to make the area less isolated. To date, however, no investment has been made. Gold was mined in Gabon from the arrival of the first colonial settlers in 1937 to the 1950s. Today, despite the discovery of a deposit at Ndangui in 1961, production has fallen considerably and amounts to only 50 kg per year, which is used on the arts and crafts market. Potential annual production is estimated at between 300 kg and 700 kg, most of it in the Eteke region. The South African group Avalanche is currently prospecting actively in the Ndangui-Longo region, as is the Canadian firm SouthernEra in the Kolissen area. The company Searchgold has just confirmed the existence of reserves in the Bakoudou region and could start production quickly if the project proves profitable. Gabon also produces diamonds and has plentiful supplies of as yet untapped iron, niobium and phosphates in virtually all its provinces except Ogooué Maritime.

Political and Social Context

The next presidential election is scheduled for December 2005. President Omar Bongo Ondiba, who has been in power since 1967, is expected to be a candidate, as the constitution was amended in July 2003 to remove the limit on the number of terms of office. The composition of the government was once again modified on 4 September 2004, when a member of the opposition was appointed. Gabon is the only country in Central Africa to have had no internal conflicts since independence and to enjoy relative social calm. After Nigeria, Ghana and the Republic of the Congo, Gabon decided in May 2004 to join the Extractive Industries Transparency Initiative (EITI). This initiative, which aims to encourage the publication of transactions between governments and the mining and oil industries, represents an improvement in terms of transparency for the country's oil sector.

Despite a GDP per capita of $6 590, Gabon has, paradoxically, the human development index of a poor country. It ranks 122nd out of 177 in the 2003 HDI, a fall of four places compared to 2002. Faced with this decline in social indicators, the authorities decided to draw up a poverty reduction strategy paper, although Gabon is not eligible for the HIPC Initiative. A poverty assessment was carried out on the basis of two existing studies, the consumption budget survey and the demographic and health survey for 2000, which are to be supplemented by a participatory survey of perceptions of poverty. As regards public sector employment, the workforce grew by 3.1 per cent in the first half of 2004 with respect to June 2003 to total 45 573 civil servants. The government departments that benefited most from this increase were social services (up 7.6 per cent, now accounting for 11.8 per cent of the public sector workforce) and transport (up 5.1 per cent to 1 per cent of the workforce). Numbers of employees fell principally in general administration (down 2.1 per cent to 13.8 per cent of the total public workforce). Life expectancy at birth in Gabon was estimated at 57.4 years in 2004, the highest in Central Africa, 12 years more than in Chad and Cameroon and 8.5 years more than in Congo. The infant mortality rate in 2004 was 53.9 per thousand, considerably better than Cameroon's 84.9 per thousand.

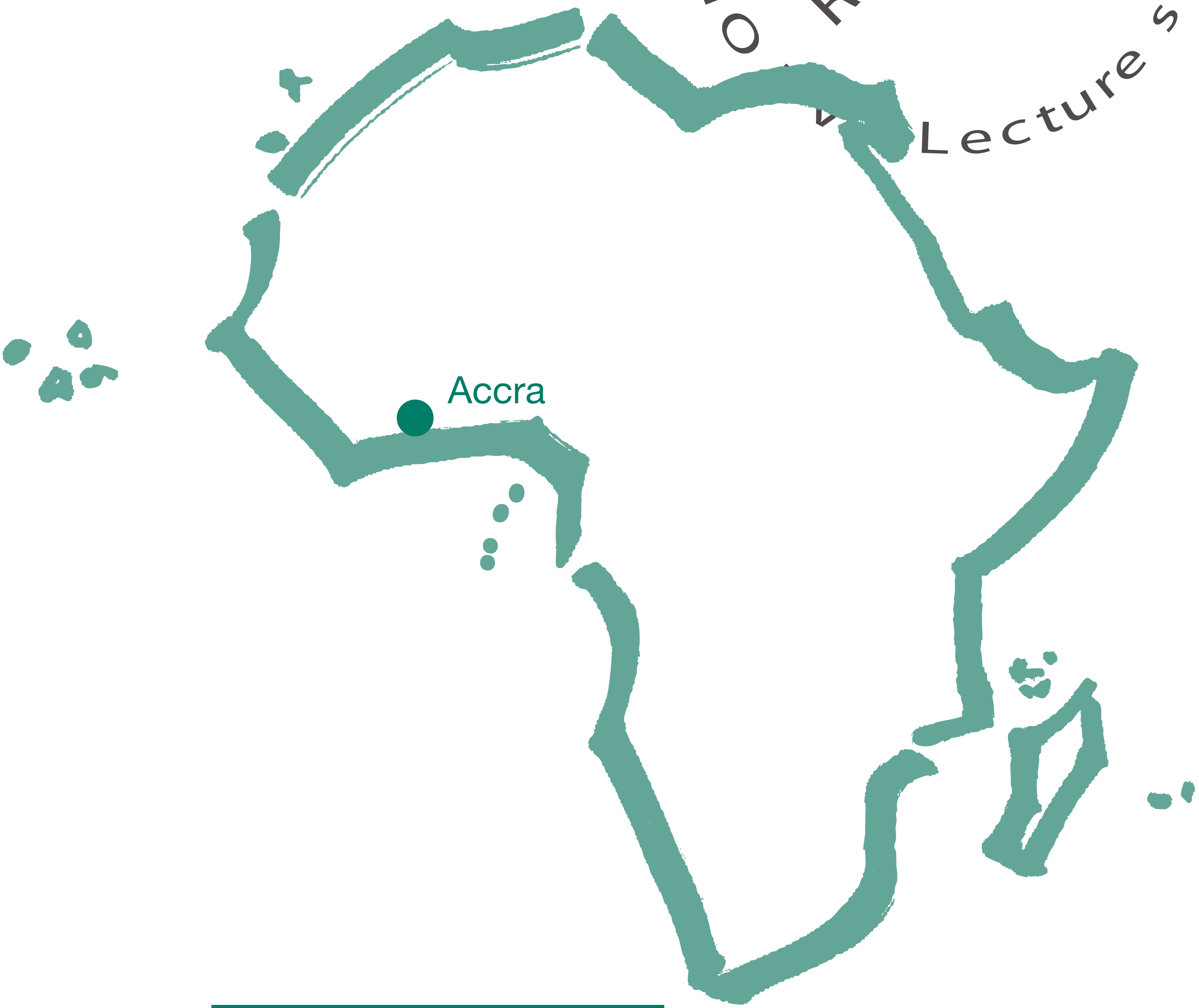
According to UNAIDS estimates, the rate of HIV/AIDS prevalence was 7.5 per cent at the end of 2003, but a 2003 report on the HIV/AIDS epidemic in Gabon, based on a greater number of tests, found a much higher rate in 2003 (14.9 per cent). The highest levels were found in the Libreville region, the maritime region and the eastern region. Progress was made in terms of gender inequality with respect to the virus: in 2000/01, two women were infected for every man, whereas parity was reached in 2002. Prevalence is higher for women over the age of 50 and for men over 45. This trend could be a sign of changes in behaviour, particularly among pregnant women, who increasingly ask of their own accord for prenatal testing (the proportion requesting such tests has risen from 12.9 to 23.1 per cent). The prevalence of HIV/AIDS infection is low among school pupils at 2.16 per cent in 2003, but interviews revealed high-risk behaviour and practices and a lack of information which could constitute a long-term menace. It is also low in the armed forces (4.2 per cent), where ignorance of the means of transmission is still widespread. Progress remains to be made, therefore, in the areas of preventive education and early detection.

Health infrastructure remains insufficient, unevenly distributed and largely privatised. The centre of the country, in particular, has a very low level of health coverage in terms of infrastructure and personnel in both public and private health facilities. Hospitals are inequitably equipped: the regional Libreville, Franceville and Koulamoutou hospitals are well equipped, while those in the south and north lack equipment for endoscopy, intensive care, laboratory services and so forth. Malaria is by far the most frequent reason for hospital consultations, for both adults and children. Despite an increase in the number of trained personnel, the number of doctors per 100 000 inhabitants remains low: 35 in Libreville, 10 in the north, east and centre, and 19 in the west and southeast.

Gabon has an overall enrolment rate (primary, secondary and higher education combined) of 74 per cent, which puts it at the same level as Malawi even though income per capita is comparable to that of Tunisia. The education system is in a very poor state and, according to the Ministry of Education, in urgent need of a diagnostic appraisal. Although nearly all children go to school in Gabon, repetition rates are among the highest in Africa for both primary and secondary education. Many children leave the school system without obtaining a primary education certificate and, when they reach adulthood, contribute to the growing demand for non-formal education and adult literacy training before joining the mass of job seekers. The percentage passing the *baccalauréat* secondary school-leaving examination is generally low and is expected to be particularly bad in 2004. The worst results are in technical and vocational education.

In the 2005 budget, the Ministry of Education is seeking to pursue three main policy objectives: increasing the coverage of the education system by improving access to and participation in the various educational levels; improving teaching quality; and improving planning and management. Schools are short of teachers despite an increase in the number of volunteer teachers, who are estimated to number more than 500. Teaching quality, which is already very low, seems nevertheless to be threatened by the very practices denounced by the minister, namely the pressure exerted on teachers with respect to obtaining good marks, admission of pupils to the next grade and enrolments. Several donor projects are due to be reactivated shortly, notably the African Development Bank's projects to rehabilitate all technical and vocational schools and build vocational senior secondary schools in Bikele and Ntoum. Lastly, the Islamic Development Bank might finance the construction of a senior secondary school in Franceville at a cost of 1.2 billion CFA francs ($2.3 million) once it withdraws its sanctions for arrears.

Ghana



key figures

• Land area, thousands of km²	239
• Population, thousands (2004)	21 377
• GDP per capita, $ (2003)	364
• Life expectancy (2000-2005)	57.9
• Illiteracy rate (2004)	21.1

IN ITS ADOPTION OF MARKET-FRIENDLY economics and democratic politics, Ghana has been among the first and most ambitious reformers in Africa. Generally prudent macroeconomic policies and substantial structural reforms have paid off in the form of steady if unspectacular economic growth and lower inflation. The economy remains reliant on cocoa and a few other primary products, although some promising signs of diversification have emerged. Ghana has benefited from the Highly Indebted Poor Country (HIPC) debt reduction programme, but debt sustainability remains tenuous. Attainment of the government's ambitious objectives regarding industrial transformation call for continued attention to macroeconomic stability while attacking structural constraints such as the lack of access to credit for local entrepreneurs.

The Ghanaian economy appears to be performing well as prudent macroeconomic policies are providing an environment favourable to sustained growth. GDP growth has also been boosted by strong agricultural performance - notably higher cocoa production, with two consecutive bumper crops. Real GDP growth rose to 5.2 per cent in 2003 and is estimated to have remained strong at 5.8 per cent in 2004. The outlook for 2005 and 2006 is for continued growth of close to 6 per cent, based on increasing cocoa production and increased investment. The government's fiscal position has improved, with stronger domestic revenue mobilisation and prudent expenditure management. However, in order to ensure enduring fiscal stability the determined reform effort must be pursued, particularly in the petroleum sector in the wake of the continuing rise in the international price of oil. Reduced petroleum subsidies are central to lowering government borrowing and thereby improving debt sustainability. Monetary policy has contributed to lowered inflation and short-term interest rates, as well as to stability in

Prudent macroeconomic policies and substantial structural reforms have yielded steady economic growth.

Figure 1 - **Real GDP Growth**

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

the foreign exchange market. The cost of capital, however, remains high. The monetary authorities may need additional sterilisation techniques to maintain effective liquidity management in response to the financing of the bumper cocoa harvests.

Structural reforms have brought about improvements in the business and regulatory environment. Nonetheless, the pace of business creation has slowed, pointing to the need for more far-reaching reforms. Limited access to credit remains a major obstacle to business creation and expansion. The financing needs of Small and Medium Enterprises (SMEs), in particular, must be addressed.

Political stability has been maintained following the December 2004 presidential and parliamentary elections. The government continues to support the rule of law and to maintain social order. However, some disturbing social problems are emerging, particularly increasing youth unemployment, due in part to an education system that fails to deliver the requisite skills. While the health system appears to be making headway in meeting the basic needs of the population, the continuing exodus of trained health workers remains worrying.

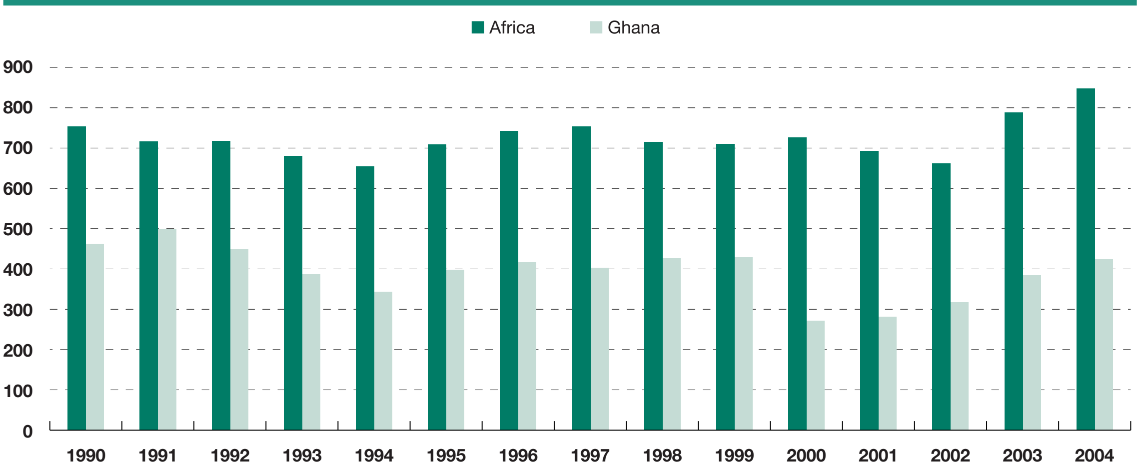
Recent Economic Developments

Ghana has aimed at accelerated implementation of the Ghana Poverty Reduction Strategy (GPRS) in the short run, while pursuing a medium-term strategy for growth aimed at attaining middle-income status by 2010. Although the economy is not yet achieving the growth rates needed to meet such an ambitious objective, its performance has continued to strengthen. Real GDP growth has remained steady with a rise from 5.2 per cent in 2003 to an estimated 5.8 per cent in 2004, despite the uncertainties associated with the presidential and parliamentary elections held in December of that year. Growth is projected to increase to 5.9 per cent in 2005 and to remain high at 5.7 per cent in 2006.

The recent growth of the Ghanaian economy has been led by agriculture – particularly the higher than anticipated output of cocoa – reflecting the impact of favourable weather conditions, improved crop management, and higher producer prices. The agricultural sector achieved its highest growth rate in nearly two decades at 6.1 per cent in 2003, followed by an estimated 6.3 per cent growth in 2004. All the major sub-sectors made positive contributions to the sector's overall growth but cocoa led the way. Cocoa's impressive performance was due largely to good policies, including mass spraying of cocoa farms to control Capsid pest and Black Pod disease, and sharp increases in the real domestic producer prices of nearly 80 per cent in real terms between the 2000/01 and 2002/03 crop seasons. Cocoa output in 2002/03 reached 496 800 tonnes – a figure surpassed only by the 581 000 tonne bumper harvest recorded in 1964/65. In 2004 production once again beat the government's own target. Independent projections of cocoa production in Ghana anticipate that output will reach 1 million tonnes a year in three years time, if current measures are pursued.

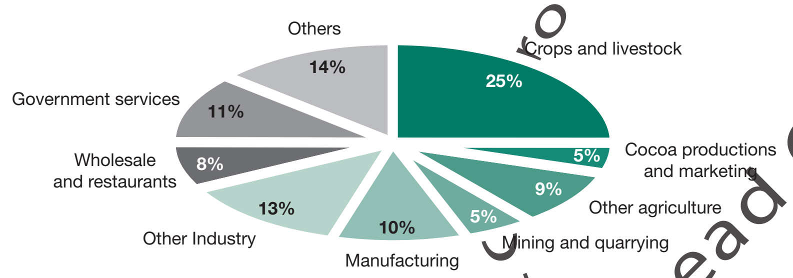
Recent improvements in agricultural performance notwithstanding, further modernisation is still required. Output expansion of cocoa and other crops in recent

Figure 2 - **GDP Per Capita in Ghana and in Africa** (current $)



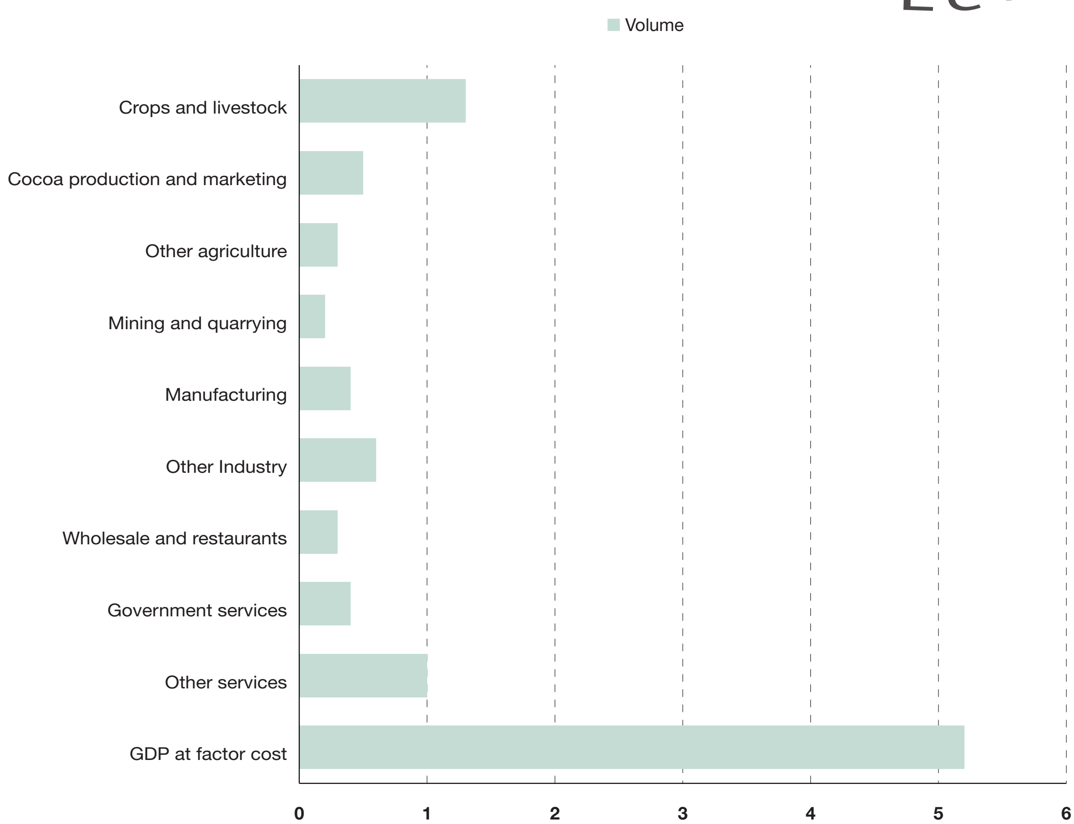
Source: IMF.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on domestic authorities' data.

years has been achieved largely because of increased acreage rather than increased productivity. The government's record in promoting productivity in the agricultural sector in areas such as farm mechanisation, irrigation facilities and access to inputs that will lead to productivity gains, remains rather poor. In 2003, for example, the government planned to rehabilitate about 1 000 broken-down tractors but failed to achieve much. Similarly, no new irrigation facilities have been provided in recent years, with the resulting uncertainty being a major constraint to higher investment in the sector.

Industrial production appears to be improving although output growth remains narrowly based. The share of industry in total GDP remained at around 27 per cent in 2003. After declining from a peak annual growth rate of 6.4 per cent in 1997 to 2.9 per cent in 2001, the industrial sector steadily recovered to post growth rates of 5.1 per cent in 2003 and an estimated 5.3 per cent in 2004. This growth is centred mainly on a few sub-sectors – petroleum and oil refining, non-ferrous base metals, cement and other non-metallic mineral products – while other sub-sectors have remained largely stagnant. Industrial diversification remains impeded by various factors, including the high cost of credit, and competition from smuggled imports. Manufacturing, the country's largest industrial sector, has stagnated since 2000. Only a modest recovery has been registered in mining and quarrying since the "gold rush" of the mid-1990s.

The recent growth in Ghana's industrial production falls well short of the government's ambitious target of 12 per cent per annum leading to the share of industry in total GDP increasing to 37 per cent by 2007. The underlying lack of dynamism in the sector is evident in the steep decline in the number of newly registered businesses since 2001, the year the government launched its "golden age of business", aimed at making the private sector the engine of the country's economic growth.

Over the past decade the service industry has been the economy's fastest growing sector. Performance remained solid in 2003 with a growth rate of 4.7 per cent, with an estimated increase to 5 per cent in 2004. The sector gained mainly on account of HIPC-funded government spending on social services, notably education. Transport and communications have also continued to expand following increased government provision of mass transport services, as well as incentives to the private sector. The inauguration in 2003 of the Kofi Annan Centre of Excellence – a collaborative ICT project between the governments of Ghana and India – and the extension in 2004 of ICT facilities to schools and colleges in the country by Ghana Telecom, contributed to an expansion in telecommunications. The number of fixed and mobile telephone lines tripled from about 300 000 in 2002 to over 1 million in 2004. Tourism continues to boom, with receipts from tourism rising by 14 per cent in 2003, and an estimated 16 per cent in 2004. However, most of the recorded tourists remain overseas Ghanaians, suggesting that the country has yet to become a major international tourist destination.

In the past, the country seemed unable to lift private capital formation substantially in line with its objective of making the private sector the engine of growth. Moreover, with a low domestic savings rate, capital investment remains dependent on foreign saving. It is expected that private investment will expand moderately in 2005 and 2006 with the improvement in the macroeconomic environment.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**21.2**	**26.6**	**19.7**	**23.2**	**24.8**	**26.8**	**28.4**
Public	14.3	12.8	6.1	9.2	10.1	10.6	11.0
Private	6.9	13.8	13.6	14.0	14.7	16.1	17.4
Consumption	**86.8**	**93.0**	**92.7**	**88.8**	**89.4**	**89.1**	**90.5**
Public	14.8	17.8	17.6	17.5	18.1	18.5	19.1
Private	72.0	75.1	75.1	71.3	71.2	70.6	71.4
External sector	**-8.0**	**-19.6**	**-12.4**	**-12.1**	**-14.1**	**-15.8**	**-19.0**
Exports	32.1	45.2	42.5	40.7	40.8	41.1	38.3
Imports	-40.1	-64.8	-54.9	-52.8	-54.9	-56.9	-57.3

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Fiscal and Monetary Policy

Ghana's main recent fiscal policy objective has been to reduce the domestic debt/GDP ratio by reducing net domestic financing. Some progress has been made towards this objective as domestic debt service was estimated to have fallen to about 3 per cent of GDP in 2004 from 5 per cent of GDP in 2003. Fiscal management, however, faces continuing challenges: widening the tax base, reducing dependence on petroleum taxes to fill the gap in domestic revenue and reducing dependence on external assistance in funding public investment.

Fiscal consolidation appears to be progressing due to improvements in tax administration that have increased revenues, as well as through prudence in expenditure management. The overall fiscal deficit has improved steadily since 2001 and was reduced to an estimated 2.7 per cent of GDP in 2004. The reduction of the deficit in 2004 was significant as it marked a break from recent election years, which were characterised by large fiscal deficits. Other developments in 2004 had negative implications for fiscal stability. In particular, the government's failure to implement the reforms in petroleum pricing in the context of rising international prices of crude oil led to unbudgeted subsidies – of 2.3 per cent of GDP – on petroleum products, which added 1 per cent to the national debt. The fiscal outlook is likely to weaken as the overall deficit is set to widen to 3 per cent of GDP in 2005 and further to 3.2 per cent of GDP in 2006, largely on account of a slow down in grant inflows.

The government has continued to adopt revenue-augmenting and expenditure-reducing measures. In 2004, total tax revenues rose to an estimated 21 per cent of GDP, the highest in about a decade. This sharp rise in tax revenues offset the petroleum-price subsidy. The revenue-augmenting measures included the implementation in August 2004 of the long delayed National Health Insurance Levy, which is estimated to yield revenues of 1 per cent of GDP annually. Efforts were also stepped up to raise non-tax revenue through enforcement of the new Financial Administration Act.

In 2004, government expenditure was brought down slightly to an estimated 28.6 per cent of GDP, from 29 per cent of GDP in 2003. Prudence in expenditure management in 2004 was enhanced through some new legislative measures, these included the Financial Administration Act, the Internal Audit Act and the Procurement Law. In addition, the government put in place the Budget and Public Expenditure Management System, currently in operation in five ministries. In 2004, the budget also gained from a reduction in interest payments from 6.2 per cent of GDP in 2003 to 4.4 per cent of GDP following the cancellation of a substantial part of the country's debt as part of the HIPC initiative.

The goals of Ghana's monetary policy remain bringing down inflation to single digits and limiting exchange-rate volatility. Recently, the conduct of monetary policy has been strengthened through the use of a Monetary Policy Committee to guide the decisions of the Bank of Ghana (BOG), and a prime

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**20.2**	**25.0**	**21.1**	**25.5**	**25.9**	**24.8**	**24.5**
Tax revenue	15.1	17.2	17.5	20.2	21.0	20.8	20.9
Grants	2.6	6.9	3.1	4.7	4.3	3.4	3.0
Total expenditure and net lending[a]	**29.7**	**32.7**	**26.1**	**29.0**	**28.6**	**27.9**	**27.7**
Current expenditure	16.4	19.9	20.0	20.0	18.8	17.6	17.1
Excluding Interest	*11.3*	*12.1*	*13.8*	*13.8*	*14.4*	*14.7*	*15.2*
Wages and salaries	5.4	6.1	8.5	8.4	8.5	8.6	8.9
Interest	5.1	7.8	6.1	6.2	4.4	2.9	1.9
Capital expenditure	13.3	12.8	6.1	8.9	9.8	10.3	10.6
Primary balance	**-4.4**	**0.2**	**1.2**	**2.7**	**1.7**	**-0.1**	**-1.3**
Overall balance	**-9.5**	**-7.7**	**-5.0**	**-3.5**	**-2.7**	**-3.0**	**-3.2**

a. Only major items are reported.
Source: : IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

interest rate now signals the policy stance of the BOG.

This inflation goal remained elusive in 2003, as petroleum price increases during the year contributed to a rise in the inflation rate of about 26.7 per cent at end-December 2003. In 2004, the average annual rate of inflation subsided steadily to an estimated 13 per cent. The fall in inflation is a reward of the responsible fiscal and monetary policies. It is expected that inflation will remain steady at 12.9 per cent in 2005 and will fall to 9 per cent in 2006 as the government's prudence in fiscal and monetary management continues.

Interest rates fell in 2004, although the real cost of capital remained high. With the fall in inflation in 2004, the BOG cautiously lowered its policy rate, which in turn contributed to the lowering of other short-term rates. The prime rate of the BOG was lowered twice in 2004, from 20 per cent in February to 18.5 per cent in May. Short-term rates declined in line with these changes, with the yield on 91-day Treasury bill going from 36 per cent in June 2003 to 18 per cent in May 2004. Also, most lending rates declined faster than deposit rates in 2004. However, the interest rate spread estimated at 22 per cent remained very high.

Although the Bank of Ghana has achieved a degree of monetary tightening, the growth in money supply has remained above target. Money supply (M2) recorded moderate growth of 18 per cent in the first half of 2004 compared to the 35.8 per cent growth experienced in 2003. The reduction in monetary expansion followed the introduction on the market of two and three year BOG bonds, reducing the demand for money.

Monetary management faces the challenge of financing the record cocoa purchases in 2004 and beyond. This requires the monetary authorities to maintain tighter monetary policies in order to minimise the impact of the external injections that are expected to finance the cocoa purchases. This may require more sterilisation instruments than are currently employed by the BOG. The BOG is contemplating the introduction of central bank paper at shorter maturities than the treasury bills, as well as the establishment of a central securities depository, to further control liquidity and to encourage the development of a secondary market.

Ghana maintains a managed floating exchange rate regime, with interventions from the central bank aimed at smoothing out short-term fluctuations in the foreign exchange market. Recently there have been signs of a narrowing of the premium between the official inter-bank rate and the foreign exchange bureau rate. This is a reflection of improvement in the efficiency of the foreign exchange market.

The foreign exchange rate of the *cedi* has remained relatively stable since the turmoil of 2000 when the local currency depreciated by about 57 per cent against the US dollar. The cedi depreciated by about 3.8 per cent against the US dollar between June 2003 and June 2004. However, the relative stability of the cedi may be threatened when the prices of petroleum products are, inevitably, adjusted in 2005 once the political justifications for maintaining the artificially low prices have been removed. The resulting price changes could affect the demand for foreign exchange, leading to higher levels of nominal depreciation.

External Position

Ghana's balance of payments objective is to increase international reserves in order to cushion the economy against short-term external shocks. As for trade policy, the government has drafted a comprehensive plan, which it intends to finalise early in 2005. The policy aims at enhancing competitiveness and gaining greater market access for Ghana's products. Regional integration within ECOWAS is a central part of the new trade policy, and the government aims to promote trade liberalisation schemes through the harmonisation and reduction of tariff and non-tariff barriers to trade within the sub-region.

The trade deficit rose from 10.3 per cent of GDP in 2003 to an estimated 11.6 per cent of GDP in 2004 and contributed to the deterioration in the current account deficit. However, the deterioration in the current account was largely the result of a sharp fall in unilateral transfers. In 2004, the value of merchandise exports was estimated to have risen by 12.6 per cent, driven largely by cocoa and gold. Cocoa export volume increased by 58 per cent, more than offsetting a 13 per cent fall in the world price. Merchandise imports grew 38.8 per cent in 2004, due to higher oil prices and strong growth in economic activity.

Ghana's external debt rose to reach an estimated $7.03 billion at the end of 2003. About 68 per cent of the total debt was owed to multilateral institutions, while bilateral creditors (Paris Club and non-Paris Club) accounted for about 26 per cent. The remaining 6 per cent was owed to commercial creditors. The debt burden – as indicated by the total debt as a percentage of GDP – and the debt service ratio have both continued to fall as a result of debt relief under the HIPC initiatives. The debt/GDP ratio fell from 121.1 per cent in 2001

Table 3 - **Current Account** (percentage of GDP)

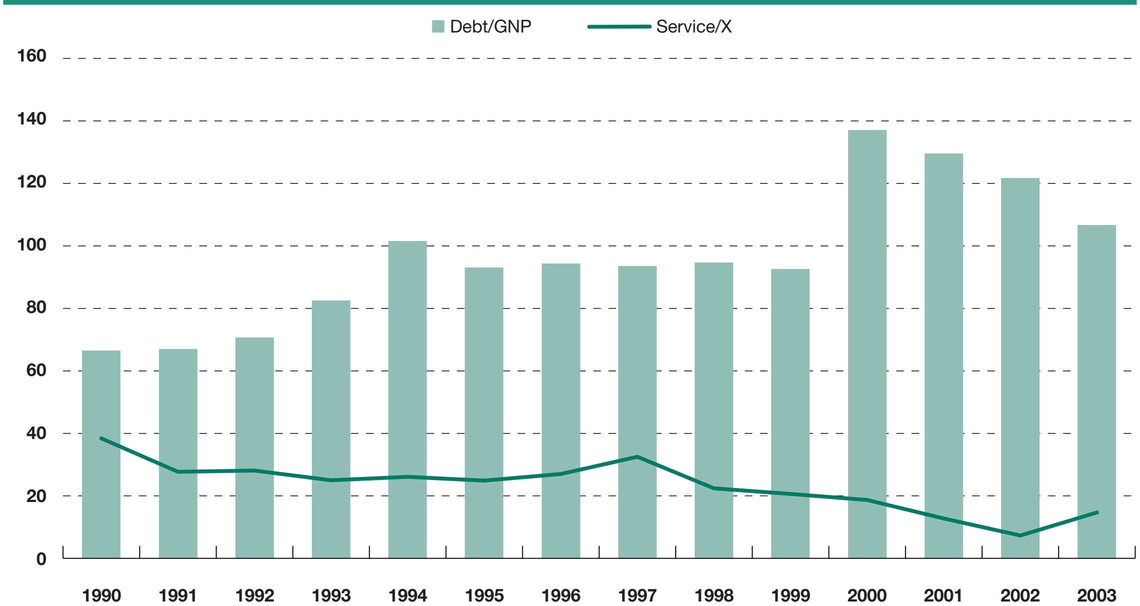
	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-7.0	-18.2	-10.7	-10.3	-11.6	-12.9	-15.3
Exports of goods (f.o.b.)	26.1	35.2	33.4	32.4	33.2	33.7	31.4
Imports of goods (f.o.b.)	-33.1	-53.3	-44.1	-42.7	-44.8	-46.6	-46.8
Services	-3.9	-1.4	-1.1	-3.6			
Factor income	-2.0	-2.0	-2.8	-2.1			
Current transfers	7.0	18.1	14.6	18.4			
Current account balance	**-5.9**	**-3.5**	**0.0**	**2.4**			

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

to 111.4 per cent in 2002, and was estimated at 89.7 per cent in 2003. The debt service ratio was estimated at 4 per cent in 2003, having fallen from 8 per cent in 2002 and from 13 per cent in 2001. The sharp decline in the debt service ratio in 2003 was due to the conversion of some eligible debt to long-term concessional loans as part of the HIPC arrangements.

The government maintains a policy of contracting new loans with a minimum grant element of 35 per cent. However, Ghana continues to contract significant short-term debt with the risk that repayments may be bunched. For example in 2003, while long-term and medium-term debt grew by 4 per cent and 17 per cent respectively, short-term debt expanded by 32 per cent.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

It is important that as Ghana enjoys the benefits of its HIPC status, it does not simultaneously set itself up for future debt problems.

Structural Issues

Ghana's structural policies currently focus on three main areas: public sector reform, financial sector reform, and private sector development.

The government's policy towards private sector development aims at creating a more business-friendly economic and regulatory environment, strengthening property rights, seeking expanded market access for Ghana's exports, and promoting entrepreneurial skills. The business and regulatory environment has improved considerably in response to earlier reforms. According to the World Bank's "Doing Business in Ghana", since 2002, the time required to start a business in Ghana has fallen from 129 to 85 days, and the licensing fees and associated costs involved in starting a business have also been reduced. Building on such successes, the government approved a new National Medium-Term Private Sector Strategy in March 2004.

Small and Medium Enterprises (SMEs) are the focal point of the government's efforts[1] to spur growth and reduce poverty. SMEs are found in both urban and rural areas, and cover a wide spectrum of economic activities. Some estimates put the contribution of SMEs to total GDP at about 22 per cent, with the largest contribution coming from those in the agriculture, trade and transport.

Ghana has a relatively long history of government initiatives to promote and finance SMEs. However, lack of finance remains the major constraint to SME development in the country. Ghana began officially promoting the activities of SMEs in 1969 with the establishment of the Credit Guarantee Scheme by the BOG to assist entrepreneurs in obtaining bank credit. This was followed in 1970 by the creation of the Ghana Business Promotion Programme. The objective of these initiatives was to provide financial and technical assistance to newly established and existing SMEs, but their impact was limited. The schemes benefited mostly politically connected Ghanaian managers of formerly foreign-owned manufacturing enterprises.

Support of SMEs was intensified in 1990 following the creation of the National Board for Small-Scale Industries (NBSSI). The major financing scheme operated by the NBSSI was a credit line – the Fund for Small and Medium Enterprise Development (FUSMED) – financed by the World Bank's small and medium enterprise project. The fund offered credit to enterprises in all sectors of the economy except primary agriculture, real estate and trading. The government also established a credit-assistance scheme under the Programme of Action to Mitigate the Social Cost of Adjustment and Development (PAMSCAD), intended to cushion the effects on SMEs of the Structural Adjustment Programmes (SAPs). The credit facility, which was managed by the NBSSI, was intended to assist entrepreneurs in procuring scarce but essential raw materials. The NBSSI, in conjunction with Barclays Bank of Ghana Limited, also implemented an EMPRETEC Ghana Programme aimed at raising funds for SMEs through the organisation of venture forums where entrepreneurs were put in touch with potential investors.

Surveys have revealed that these government initiatives to help finance SMEs have failed to make a major impact. One is the reasons for this is that SMEs have had limited awareness of the credit schemes. Also, the schemes were focused on urban areas: it has been estimated, for example, that only about 5 per cent of the beneficiaries of NBSSI credit for SME promotion came from rural areas.

In addition to the government's efforts, the influence of financial initiatives from commercial, merchant, and development banks to improve the lot of SMEs has also been limited. Available information indicates that

1. SMEs are defined as enterprises capitalised at not more than 10 million cedis or $100 000 and with a labour force of not more than nine persons.

commercial banks involved in micro-finance achieved a 98 per cent recovery rate on loans to SMEs over the decade 1993-2003. Nonetheless, credit from these sources usually requires collateral that SMEs operating in rural areas do not have. Thus very few applicants from the SME sector are eligible for loans. Moreover, interest rates, which averaged at 37 per cent between 2000 and 2003, are prohibitive for most SMEs.

The government has set up rural banks to help SMEs in obtaining credit. These are independent unit banks whose operations seek to bring banking facilities and credit to rural communities, and to mobilise savings. Increasingly the rural banks are viewed as failing in these tasks as they tend to favour transport operators to the exclusion of other SMEs, transporters often being better able to make regular payments to the banks.

There are several informal mechanisms through which SMEs obtain finance, but these have major weaknesses. Traditionally, private moneylenders have been a major source of finance for SMEs. In such markets, lenders and borrowers know each other and quick decisions can be reached on loan requests, without any formalities. Also, this arrangement is the only source of informal credit that does not require borrowers to satisfy specific social obligations such as group membership. However, credits from moneylenders tend to have very short maturities and high interest rates. Credit from the *susu* mechanism, where individuals make daily savings with another person (the collector), are usually in very small amounts, although the interest rate may be low. By and large the *susu* system has served the needs of low-income earners interested in short-term working capital. The relatively low interest rate, along with the convenience of making repayments through regular schedules, makes this system attractive for entrepreneurs who have regular cash flows, however small.

Credit associations and co-operatives offer the possibility of taking out bigger loans than those available under the *susu* mechanism. However, only a limited numbers of borrowers may have access to funds at any time. This limitation restricts the use of these sources to those borrowers whose demand for loans is not regular. A typical example of financing from credit associations in Ghana is the Rotational Savings and Credit Association (ROSCA). This involves a group of participants who make regular contributions to a fund, which is made available in whole or in part on an interest-free basis to each member in turn. ROSCAs in Ghana have provided some entrepreneurs with the necessary capital to start a business, replace trading stock and buy machinery to repair equipment. The success of these associations is due to their accessibility, simple procedures and flexibility.

Financial sector reform remains a key component of the government's efforts to promote private sector development. The Banking Act, which became law in 2003, strengthened the supervisory powers of the Bank of Ghana over commercial banks. In 2004, the government introduced a new Companies Code and commercial courts were made operational to facilitate business conflict resolution. Also in that year, new legislation designed to improve insurance regulation and credit information, and to fight against money laundering, was promulgated. The government is currently working on a long-term savings bill, which will facilitate the development of private pensions and housing finance.

Within the banking sector, the uncertainty that surrounded the privatisation of the Ghana Commercial Bank (GCB) in 2003 was resolved in 2004. The government's new proposal for selling off GCB is via a share flotation. It was expected that a management contract would be put to competitive bidding after the completion of the share issue by the end of 2004. The delay in the privatisation of the GCB is reflected in the bank's poor performance indicators. For example, the performance indicators of the GCB are considerably poorer than those of Barclays and Standard Chartered Banks. In 2003, while the GCB recorded an insolvency index (provision of bad debts as a percentage of total loans and advances) of 6.4 per cent, the indexes for the other two commercial banks were much better at 3.3 per cent and -0.99 per cent respectively.

The government continues to pursue public sector reforms on several fronts. Attention was focused recently on the Tema Oil Refinery (TOR), which as a strategic state-owned enterprise has in the past not been allowed to charge competitive prices for its petroleum products. This led to the accumulation of massive debts to the banking system. As part of the reforms the government converted a portion of the TOR debt into TOR bonds, and put in place an automatic adjustment formula for petroleum prices that, in effect, was to bring petroleum prices in the country in line with world market levels from the beginning of 2003. In addition, an independent National Petroleum Tender Board was given responsibility for adjusting petroleum prices. Reforms were also developed aimed at achieving full cost recovery in the utility companies, Electricity Company of Ghana and the Ghana Water Company. The failure of the government to implement the automatic pricing formula for petroleum, and utility tariff adjustment in January and April 2004, which implied government subsidies to compensate TOR and the oil marketing companies for under-recovery of their costs, raised concern about how far political considerations could undermine the government's resolve over reform.

The government has made further progress in improving the financial performance of major state-owned enterprises through a strategy of establishing monitorable financial plans. In 2004 the government completed an audit of the cross-debts of the Volta River Authority (VRA), the Electricity Company of Ghana (ECG), the Ghana Water Company Limited (GCWL) and the TOR to each other. In the same year, some of the companies submitted to the government detailed measures designed to raise efficiency and reduce costs, as well as financial performance plans. The government made progress with its plans to take a minority stake in the Volta Aluminium Company (VALCO). The government's interest in buying into VALCO is based on the rationale that as an equity partner, it could ensure that other new private investors would give due consideration to the development of Ghana's vast bauxite deposits. In October 2004 parliament approved the government's proposal to buy into VALCO, subject to clarifications on the company's liabilities, the government's ability to secure a strategic investor, and the government's ability to strike a deal on electricity prices for the company. The IMF, however, has expressed reservations, about the plan.

Political and Social Context

Ghana's political system remains stable and democracy appeared to be functioning well as the country moved towards presidential and parliamentary elections in December 2004. Despite considerable tension and some violence following the polls, the election took place relatively peacefully and was adjudged free and fair by the international community. The political situation has since remained stable. The elections returned the ruling New Patriotic Party and President Kufour to power for another four-year term.

Governance was further improved with the introduction in 2004 of the Freedom of Information Bill and the Whistle Blowers Bill, aimed at enhancing individual freedoms and civil society's participation in national affairs. The government's confidence in its respect for democratic principles was demonstrated by Ghana volunteering for scrutiny under the NEPAD Peer Review Mechanism, the first of which was undertaken in May 2004.

Unemployment is becoming a major problem in Ghana. The slow pace of past growth, coupled with an expanding labour force, has resulted in increasing unemployment: the rate of unemployment rose from 10.4 per cent in 2000 to 12.2 per cent in 2003. A disturbing dimension of the unemployment problem is the growing joblessness among university graduates. Unemployment rates are also high among the graduates of the middle and junior secondary schools (JSS), which often fail to provide the requisite skills.

The government's health policies appear to be making some headway, although the health system continues to suffer from an exodus of health personnel. Available information indicates that over the decade to 2003, Ghana lost over 30 per cent of its trained health personnel. The government's health policy aims at *i)* enhancing delivery and increasing access to health services; *ii)* improving access to safe water and sanitation in rural areas; and *iii)* ensuring sustainable health care financing. The programme of improving health care delivery, a component of the National Health Insurance Scheme, was boosted in 2004 as the National Health Insurance Levy was belatedly implemented in August of that year. Implementation had been delayed by opposition from organised labour to the use of 2.5 per cent of workers' social security contribution to finance the plan. The National Health Insurance Scheme was piloted in 45 districts in 2004. During that year the government also began implementation of a subsidised anti-retroviral (ARV) treatment for HIV/AIDS patients.

The government's education policy continues to focus on free and compulsory basic education, defined as primary school and JSS. Since the programme began in 1996, significant progress has been made towards the PRSP aim of achieving a national primary school enrolment ratio of 88.5 per cent by 2005. Despite considerable regional variation, the national primary school gross enrolment ratio has continued to improve rising from 79.5 per cent in 2002 to 81.1 per cent in 2003. Gross enrolment at the JSS level, however, is less impressive. Moreover, students are performing poorly in basic subjects at the JSS Basic Education Certificate Examinations: in 2003, as many as 40 per cent of all pupils failed this test in mathematics and in science.

Kenya

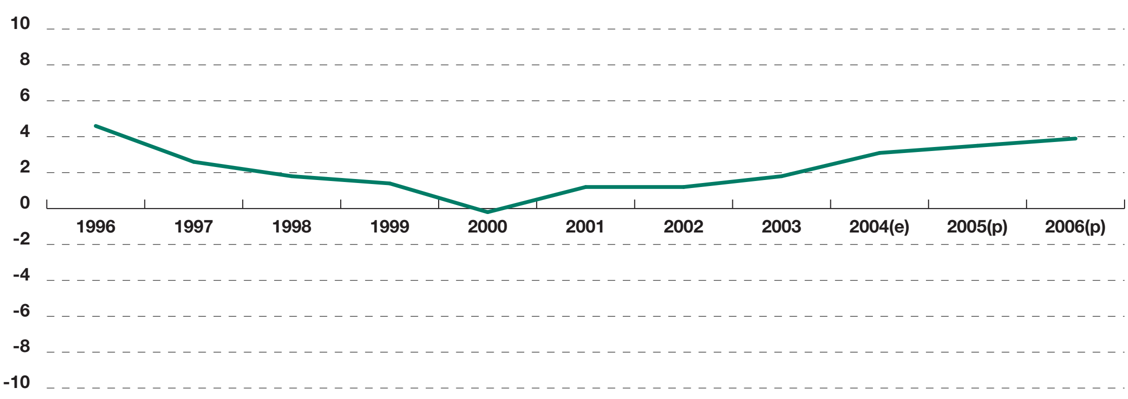
key figures

• Land area, thousands of km²	580
• Population, thousands (2004)	32 420
• GDP per capita, $ (2003)	449
• Life expectancy (2000-2005)	44.6
• Illiteracy rate (2004)	14

SINCE 2003, KENYA HAS MADE significant progress in reversing its poor economic performance of the preceding decade. Following a protracted recession, a modest rebound in economic activity has got underway: fiscal performance has strengthened under the IMF-supported programme approved in November 2003, and some steps have been taken towards improving governance. In the political sphere, progress has been made towards reaching a broad consensus on the elements of a new constitution. However, inflation has accelerated sharply in recent months, there have been delays in implementing reforms in public expenditure and the financial sector, and poverty alleviation has been hampered by delays in initiating social programmes and weak donor support. The main challenge for Kenya is to accelerate broad-based growth to help reduce poverty and improve the delivery of public services, while securing fiscal discipline and restoring price stability. With these objectives in mind, the authorities plan to further improve revenue collection, contain the wage bill and reorient public expenditure in favour of essential social and economic outlays, tighten monetary policy, broaden and accelerate structural reforms (including the privatisation programme), pursue their strategy of good governance, and promote increased donor support. To foster private sector activity and improve Kenya's competitiveness, the government strategy includes efforts to improve the current regulatory environment in order to reduce the cost of doing business. Micro-financing is being considered as a possible way of meeting the financing problems of the country's sizeable SME sector.

Economic recovery appears underway but accelerated broad-based growth is needed to reduce poverty and improve public service delivery.

Figure 1 - **Real GDP Growth**



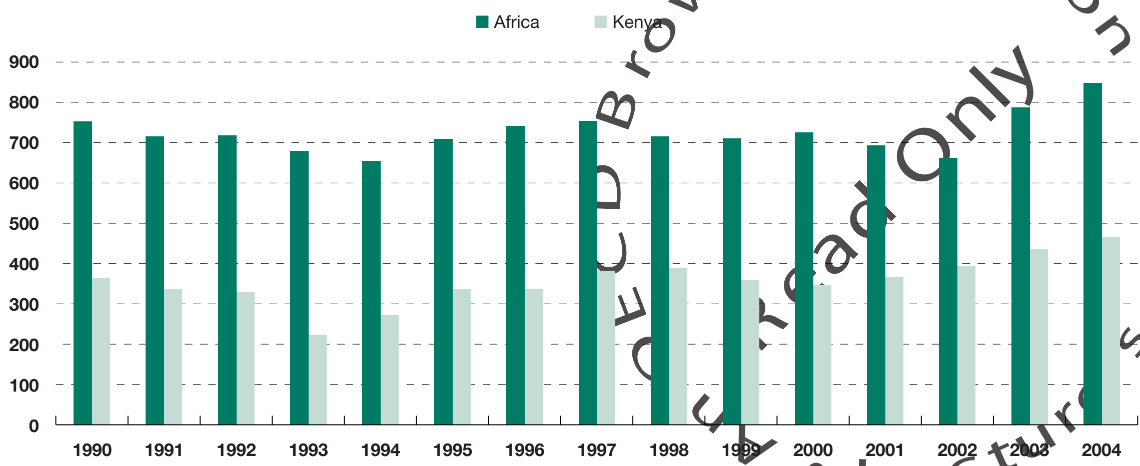
Source: Domestic authorities data; estimates (e) and projections (p) based on authors' calculations.

Recent Economic Performance

The Kenyan government is implementing an Economic Recovery Strategy to promote strong economic growth and increase employment. The programme for 2003/04–2005/06 aims at creating opportunities for productive employment through the rebuilding of sound governance structures, addressing the country's major macroeconomic vulnerabilities - particularly its weak budgetary position, large domestic debt and distressed financial system -, and reforming the parastatal sector, the labour market and the trade system to foster a more competitive private sector.

The Kenyan economy is starting to recover from what has been one of the country's longest recessions.

Figure 2 - **GDP Per Capita in Kenya and in Africa** (current $)



Source: IMF.

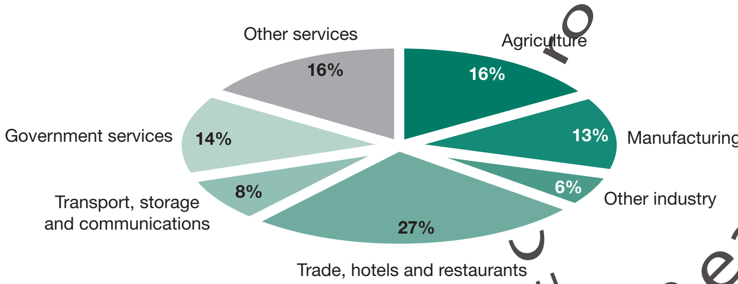
In 2003/04 real GDP grew by 3.1 per cent up from 1.8 per cent in the previous year. These first steps towards recovery have, however, been narrowly based: growth has been driven by an upturn in the tertiary sector, while primary sector output has been adversely affected by drought. Economic growth is expected to reach 3.5 per cent in 2004/05, and is projected to rise to 3.9 per cent in 2005/06, based on a broad-based performance in almost all sectors.

The performance of the agricultural sector - like that of the rest of the economy - remains below potential as a result of a number of factors. First, the sector has suffered from drought since 2000. In addition to this, the terms of trade have deteriorated owing to increases in agricultural input prices coupled with lower prices offered for agricultural produce. In 2004, the government initiated the Strategy for Revitalisation of Agriculture (SRA) to improve the contributions of the sector. In the context of the SRA, a sector-wide Kenya Agricultural Productivity Project (KAPP) was introduced to support essential activities such as research and extension services to farmers. Erratic input price movement continues to affect investment, production and profitability in the agricultural sector: finding a way of dealing with this problem would be an immediately effective way of improving agricultural output. The current instability in this area relates to the serious governance issues in the agricultural input market and requires reforms to enhance competition in input distribution and marketing.

Kenyan manufacturing appears to be responding positively to the domestic incentives introduced in 2003. Output growth in the manufacturing sector rose by 1.4 per cent in 2003, and is estimated to have expanded by 1.8 per cent in 2004 on the strength of the agro processing industries, dairy production, fish processing, fats and oils, as well as drugs and medicines, perfumes and toiletries. Key factors that have contributed to the improving performance include tax exemptions for the majority of inputs and the enforcement of anti-dumping measures to protect local industry. However, the expansion of manufacturing output remains constrained by low domestic consumer demand, high energy cost, and the recent depreciation of the Kenyan shilling. The textile industry in particular appeared unprepared for the challenge of the new WTO regulation that permits unrestricted textile exports following the expiry of the Multi-Fibre Arrangement at end-2004. The government has attempted to help the industry by introducing improvements in the administration of tax incentives aimed at encouraging trade in new, cheap and quality clothing to boost the local industry. The government has also increased vigilance to avert inflows of counterfeit and sub-standard goods that compete with local manufactures.

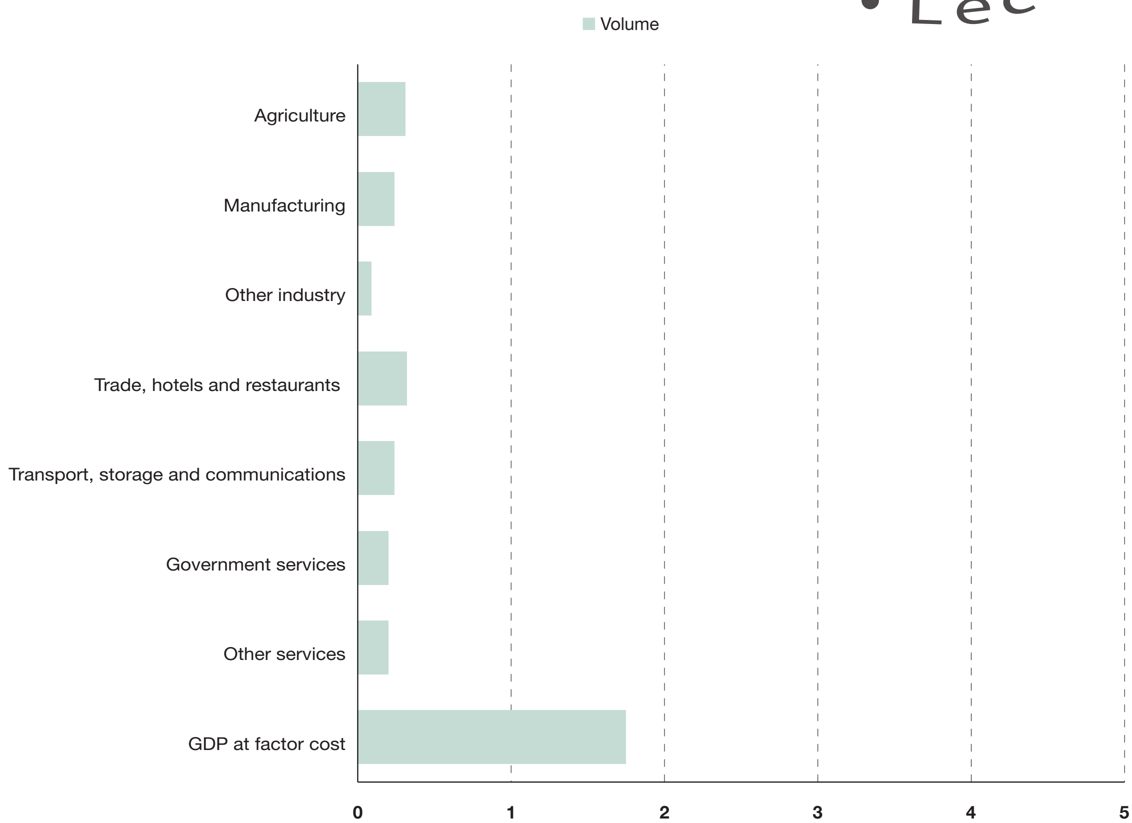
The service sector remains dominant and accounted for about 56 per cent of GDP in 2003. The tourism sector, which had hitherto driven growth in the service sector, suffered in 2003 from a decrease in the number

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on domestic authorities' data.

of visitors to Kenya, following negative travel advice by the United States of what they perceived as high security risks in the country. Tourism earnings, however, recorded an improvement in that year. The tourist trade continued to struggle to regain lost ground in 2004 by promoting domestic and conference tourism. According to preliminary estimates, tourist receipts increased by an estimated 22 per cent in 2004. Although it is expected that earnings from tourism will continue to rise in 2005, there are concerns regarding the falling numbers of tourists to Kenya. The government expects that the removal of the travel advisories by the United States, along with continued efforts to improve security at the major holiday centres, will bring the tourists back to Kenya.

Indicators of the transport and communication sector continued to show increased activity for almost all sub-sectors. The recent boom in telecommunications was sustained as the number of companies licensed to offer services in telephone connections and internet services continued to rise. Landline phone capacity and mobile phone connections increased significantly, the latter following the introduction of "Simu ya Jamii" (community phone) mobile pay phones to the market in 2003. The regional operator, Bell Western, which was licensed in 2003 to offer on line service, also began operations in 2004.

Kenya's economic performance remains characterised by low and declining savings that lead to poor domestic capital formation. In 2003, gross capital formation fell to its lowest level in several years. Gross capital formation picked up in 2004, with further strengthening on the horizon. However, Kenya's capital formation performance remains below that of several other African countries. Determined efforts to speed up reforms will be required if domestic savings are to be improved as economic activity picks up, and to enhance the inflow of foreign savings for domestic investment.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**20.3**	**14.6**	**13.4**	**12.9**	**13.7**	**14.7**	**15.4**
Public	3.6	5.1	4.6	4.4	4.4	4.7	5.2
Private	16.8	9.5	8.7	8.5	9.3	10.0	10.2
Consumption	**84.0**	**94.9**	**92.1**	**91.7**	**89.2**	**89.8**	**89.8**
Public	16.0	19.2	19.1	17.9	17.6	18.3	18.5
Private	68.0	75.7	72.9	73.8	71.7	71.5	71.3
External sector	**-4.3**	**-9.5**	**-5.4**	**-4.6**	**-2.9**	**-4.5**	**-5.2**
Exports	32.6	26.6	26.0	24.9	27.1	26.8	25.3
Imports	-36.9	-36.2	-31.4	-29.5	-29.9	-31.3	-30.5

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Fiscal Policy

The fiscal challenge facing the Kenyan government is to re-establish fiscal sustainability while reorienting the budget toward poverty reduction programmes and development expenditure. In recent years, fiscal operations recorded a declining trend in the ratio of revenue to GDP (from 29 per cent in 1995/96 to 21.7 per cent in 2001/02), while expenditure on debt service and wages remained stable. This situation created serious policy conflicts, with resources allocated to development and social expenditure being squeezed out, resulting in deteriorating public service delivery. In addition, the state's high borrowing requirement resulted in a rapidly increasing public debt – which exceeded 50 per cent of GDP by 2002 – and the government incurring substantial arrears.

In FY 2003/04, fiscal performance strengthened in the framework of the Poverty Reduction and Growth Facility (PRGF) programme agreed with the IMF in November 2003. This performance reflected a strong total revenue collection, which increased to 22.8 per cent of GDP in 2003/04, as measures were taken to rebuild the credibility and improve the capacity of the Kenya Revenue Authority, and to reform the customs administration. In parallel, the management of recurrent expenditure was tightened. Furthermore, Kenya received Houston rescheduling terms from Paris Club creditors in January 2004 despite its IDA-only country status.

In view of the slow resumption of donor budgetary assistance, the authorities revised their initial budget

Table 2 - Public Finances[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total Revenue and grants[b]	**30.4**	**25.3**	**21.7**	**22.1**	**22.8**	**23.0**	**22.5**
Tax revenue	24.8	19.5	17.6	17.5	17.7	17.8	17.9
Grants	1.2	1.5	1.3	1.5	1.9	1.9	1.4
Total expenditure and net lending[b]	**30.4**	**25.3**	**24.1**	**24.1**	**24.4**	**25.3**	**25.4**
Current expenditure	24.5	21.1	21.2	20.8	20.4	21.4	21.2
Excluding interest	*17.0*	*18.2*	*18.0*	*17.4*	*17.4*	*18.2*	*18.8*
Wages and salaries	5.0	8.6	8.9	8.7	8.7	8.6	8.6
Interest	7.5	2.9	3.2	3.5	3.1	3.2	2.4
Capital expenditure	5.3	3.9	2.8	3.3	3.9	3.9	4.2
Primary balance	**7.6**	**3.0**	**0.8**	**1.4**	**1.4**	**0.9**	**-0.5**
Overall balance	**0.1**	**0.0**	**-2.4**	**-2.0**	**-1.7**	**-2.3**	**-2.9**

a: Fiscal year begins 1 July.
b: Only major items reported.
Source: Domestic authorities' data; projections (p) based on authors' calculations.

for 2004/05, allowing for a more modest expansion in poverty reduction programmes and development expenditure, while increasing domestic borrowing to 2.5 per cent of GDP. The authorities intend to pursue their efforts to improve revenue performance in 2004/05 despite the adverse effect expected from the introduction of the Common External Tariff (CET) by the East African Community (EAC) on 1 January 2005, and to restructure expenditure to permit increased allocations for roads, health and agriculture. The authorities plan to address the problem of budget rigidity through a new wage-setting mechanism for public employees linking wage awards to revenue growth.

The overall fiscal deficit declined from 2 per cent of GDP in 2002/03 to 1.7 per cent in 2003/04; it is expected to rise slightly to 2.3 per cent of GDP in 2004/05 and again to 2.9 per cent of GDP in 2005/06.

Monetary Policy

Kenya's monetary policy is aimed at achieving domestic price level stability. The monetary authorities' success in controlling movement in monetary aggregates in the course of 2001 and 2002 contributed to keeping inflation low. This achievement was reversed in 2003 as banking credit to the government drove a substantial increase in monetary aggregates: broad money supply (M3) increased by 13 per cent, compared with 10 per cent in 2002. The attempt by the Central Bank of Kenya to rein in the growth of money supply (M3) in 2004 to 8 per cent appears to have been unsuccessful, as monetary expansion was estimated at 12.6 per cent during the 12-month period through to September 2004.

The loosening of monetary policy, together with the increase in oil price and drought-related shortages of food commodities, has led to an increase in inflation. The annual average rate of inflation rose markedly from 2 per cent in 2002 to 9.8 per cent in 2003, and jumped to an estimated 11.1 per cent in 2004. The government has allowed both oil and food prices to adjust fully to the increase in imports prices, with appropriate safety nets to protect the poor. The prices of gasoline and kerosene (the major source of lighting and cooking energy for about 80 per cent of the population) were raised by 22.7 per cent and 33 per cent, respectively, between October 2003 and October 2004. The outlook for inflation is moderation as food production is expected to improve and monetary conditions to be less expansionary. The annual average rate of inflation is projected to decrease to 6.2 per cent in 2005 and to 5.4 per cent in 2006.

Interest rates have not risen in pace with inflation, resulting in negative interest rates, as banks' reserve requirement was lowered from 10 per cent to 6 per cent in July 2003. The rate on the benchmark 91-day Treasury bills averaged 1.41 per cent at end-December 2003 and 2.75 per cent at end-September 2004.

Kenya maintains a flexible exchange rate system to complement its trade reforms and to ensure an appropriate structure of economic incentives for producers. In 2003/04, the Kenya shilling depreciated by 8.2 per cent in real terms. The depreciation reflected increased foreign currency demand associated with the lax monetary policy, high oil prices, and to an extent, speculative pressures following delayed donor inflows.

External Position

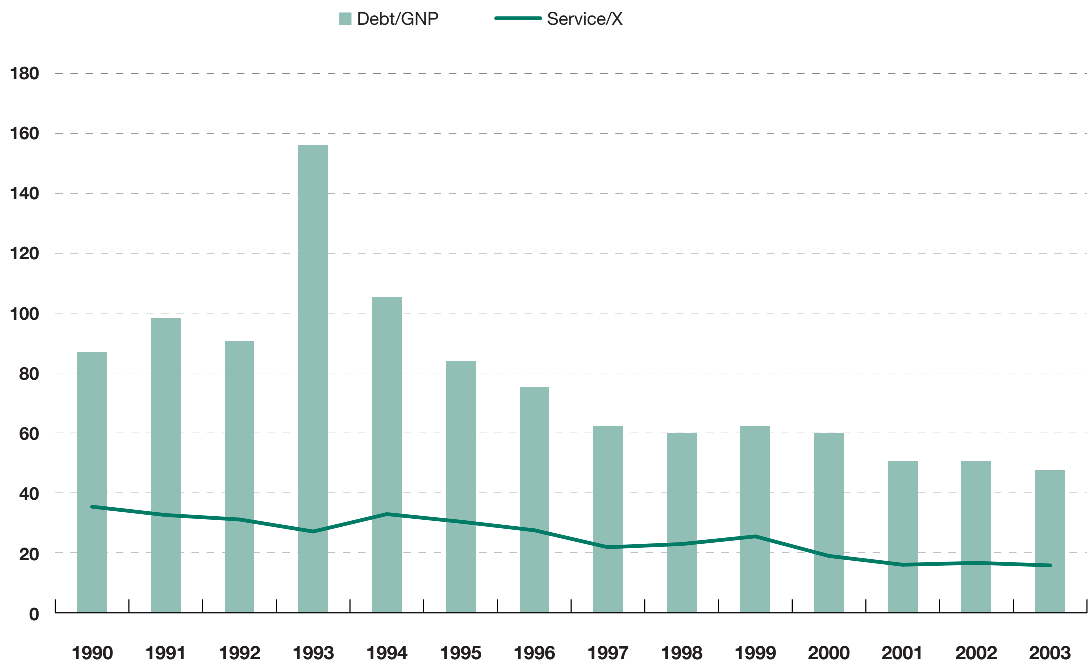
Kenya maintains a liberalised external trade system, although there are some import controls based on health, environmental and security concerns. In addition imports are subject to a pre-shipment inspection for quality, quantity and price. The country's trade policy is increasingly oriented towards regional integration, with the focus of the integration being on COMESA (Common Market for Eastern and Southern Africa), and the EAC (East African Community), which now account for most of Kenya's trade within Africa. The EAC Customs Union, which came into force on 1 January 2005, lowered Kenya's maximum tariff rate

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-5.6	-12.0	-8.2	-7.9	-8.6	-10.2	-10.4
Exports of goods (f.o.b)	22.5	16.9	17.7	16.9	16.8	16.6	15.6
Imports of goods (f.o.b)	-28.1	-29.0	-25.8	-24.8	-25.5	-26.7	-26.0
Services	1.1	2.5	2.7	3.3			
Factor income	-2.4	-1.1	-1.2	-0.6			
Current transfers	4.8	7.2	5.2	5.7			
Current account balance	**-2.1**	**-3.4**	**-1.5**	**0.5**			

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

from 35 per cent to 25 per cent.

Kenya's external accounts position has remained fragile in spite of improvement in the terms of trade in 2003, which reversed the deterioration of the preceding four years. The contraction in the trade deficit in 2003 that led to an improvement in the current account was reversed in 2004 as a result of higher imports (in value terms), notably petroleum products and food items. Tea and horticulture together accounted for about 50 per cent of total export earnings in 2004. The external accounts position may be expected to deteriorate as the trade deficit widens in 2005 and 2006.

Kenya's external debt is low and remains on a declining trend. It stood at $5 billion at end-2003. Multilateral organisations continued to be the leading creditors, accounting for 62 per cent of the total debt, while bilateral creditors accounted for 32.2 per cent. The remaining 5.8 per cent of the total debt was owed to commercial banks. Japan and France were the leading bilateral creditors, while the International Development Association (IDA) and the African Development Bank – Kenya's leading development partners for many years – were the dominant multilateral creditors. The total debt was equivalent to 35 per cent of GDP in 2003 (80 per cent in 1996), well below the thresholds of the enhanced HIPC Initiative. The debt service ratio has also declined from 24 per cent in 1996 to 22 per cent in 2003. Other key debt ratios and debt service burden indicators are also relatively low and Kenya's external debt is sustainable. As mentioned above, Kenya rescheduled its debt with Paris Club creditors in January 2004 and it settled the modest amount of non-rescheduled arrears to Paris Club creditors by November 2004. The authorities have undertaken an audit of Kenya's external commercial contracts for governance reasons.

Structural Issues

Despite the structural reforms undertaken since the 1990s to diversify the economy and attract investment, the lack of necessary infrastructure and the current regulatory and legal framework are still imposing a significant burden on private business activity and thereby hindering faster growth. The private sector is facing problems of security, a lack of harmonisation of government procedures and widespread corruption.

Kenya's privatisation programme, which has been ongoing since 1992, has made some limited progress. The privatisation process suffered a major setback when the Privatisation and Sale of Assets Bill was not enacted as planned in 2003. In the course of the following year the government put together a privatisation programme. This plan targets a number of commercial public enterprises in the agricultural, tourism and financial sectors for privatisation or management contracts, as well as major parastatals including Telcom Kenya, KenGen, KPA, and Kenya Railways Corporation. The programme also sets out the government's intention to sell its shares in the Kenya Commercial Bank. However, the privatisation process requires the enactment of the necessary legislation, which is still pending before the Parliament.

In spite of the financial sector reforms pursued in the past, Kenya's financial system is still ailing. Its weaknesses include: *i)* high level of Non-Performing Loans (NPLs) arising from political lending from public sector banks, insider or connected lending, and pervasive legal problems in enforcing creditor rights; *ii)* under-capitalisation, which leaves banks vulnerable to negative shocks; *iii)* low or negative profitability and high costs, despite large intermediation margins, with spreads between lending and deposit rates of about 13 percentage points; *iv)* weak banking supervision; and *v)* a fragmented legal framework for insolvency and creditor rights, with outdated insolvency laws.

The government has started addressing the existing problems in the financial system. Reforms were introduced in 2003 to improve governance in the banking industry by enabling the central bank to access information on bank interests and other charges. In 2004, the government introduced a comprehensive Financial Sector Reform Strategy that calls for major changes to the Banking Act, including the transfer of operational and licensing powers from the Minister to the Central Bank. In accordance with the Basel Accord, significant shareholders would be subject to vetting by the Central Bank. The introduction of the so-called "In Duplum" rule would safeguard the interests of borrowers by introducing a cap on interests charged on non-performing loans. Also in 2004, the government sought to enhance corporate governance in the banking sector by *i)* requiring the continuous vetting of the chief executive, directors and significant shareholders of banks and financial entities prior to assuming responsibilities; and *ii)* restricting lending to any one shareholder to no more than 25 per cent of the core capital.

Kenya has a sizeable SME sector that the government is attempting to promote. SMEs encompass businesses employing up to 50 workers. The sector was estimated to employ about 3.2 million people and contributed about 18 per cent of total GDP in 2003. Earlier government policies aimed at promoting the SMEs were based on welfare considerations: SMEs were regarded as potential generators of employment, vehicles for achieving balanced regional growth and as counterweights to the concentration of economic power by larger firms. This contributed to keeping the SME sector in Kenya weak and uncompetitive.

Although the problems faced by SMEs in Kenya vary by sector, limited access to financing is a problem that is experienced across the board. In spite of Kenya's relatively large financial services sector, only about 10 per cent of the population is estimated to have access to banking services. The bulk of the poor, who mostly live in the rural areas, have no access to formal financial services. Consequently, small entrepreneurs start their business by investing their own savings and/or using funds obtained from relatives or friends. This might be supplemented by loans from informal lenders or by credit from suppliers. It is only after the business has been operating for some time, usually as a micro-enterprise or on a small scale, that any attempt is made to seek financing from a bank for further development and expansion.

The main reason why commercial banks are reluctant to lend to the SMEs is that this type of business seldom has any credit history or marketable assets to use as collateral. Bank lending to SMEs is usually done after on-site inspections - which may also include house visits - to assess what tangible assets the client owns. Thereafter, loans are awarded on an incremental basis and the client keeps getting more once the previous loan has been successfully repaid.

There are a large number of micro-finance institutions involved in providing financial services to people with low incomes, as well as to SMEs. There exist about 4 000 Saving and Credit Co-operative Societies (SACCOs). SACCOs are member-based institutions found both in the rural and urban areas of Kenya: members have to save a fixed amount in order to qualify for SACCO credit which can be used for starting up or promoting an existing business. While SACCOs are an important provider of financial services for rural SMEs, one major weakness has been their limited outreach capacity in areas without a major cash crop. This includes the greater part of marginal areas in Kenya where the bulk of the poor live. SACCOs can also guarantee loans from the Co-operative Bank of Kenya for one or several of their members operating as an SME. In addition to the SACCOs, there are about 1 million rotating and accumulating savings and credit associations (ROSCAs and ASCRAs), which are a form of "merry-go-round". They mostly provide goods or capital to their members for starting or enhancing businesses. Finally, there are about 130 other micro-finance organisations recorded by the Central Bureau of Statistics.

Micro-finance institutions face major obstacles in their operations, including the lack of a mechanism to track and recover loans, a lack of co-ordination, a lack of commitment from the borrowers, and the use of counterfeit documents as collateral. Furthermore, they suffer - as do the commercial banks - from the lack of a supportive judicial system and effective administration of property rights.

Political and Social Context

Since the political transition in December 2002, which brought the National Rainbow Coalition to power, Kenya's participatory democracy and political pluralism has appeared to be stable and working well. However, differences within the ruling government, with roots in the pre-election formation of the Coalition, have surfaced of late. This division is holding up progress towards the New Constitution of Kenya.

The government has shown commitment to maintaining the rule of law, peace and security. In this regard, the capacity and co-ordination of public safety and law and order institutions have been strengthened. The efficiency of the judiciary has also been improved; more judicial officers have been appointed and the law courts are being rehabilitated. In order to free the courts of petty cases, in 2004 the government drew up plans to establish small claims courts. The government now has an anti-corruption strategy, which involves civil society. The Kenya Anti Corruption Commission (KACC), which came into being in its present form in 2003 after the enactment of the Anti Corruption and Economic Crimes Bill, has responsibility for investigating and prosecuting in corruption and economic crimes cases. There is now an office of a permanent secretary in charge of ethics and governance who reports directly to the president. In addition there is the Kenya Human Rights Commission (KHRC), which is now quite vocal on matters of governance in Kenya.

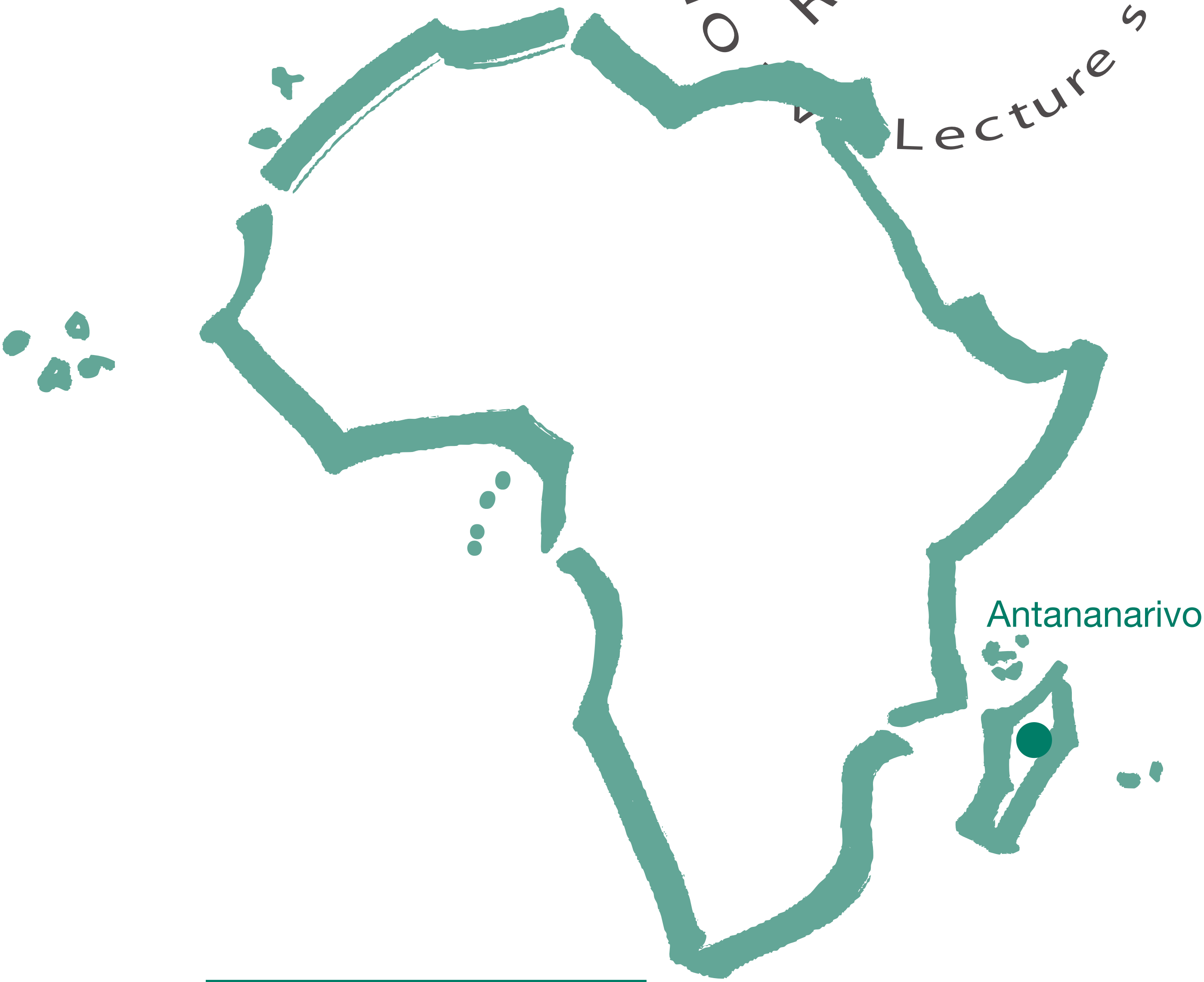
The operations of institutions set up to safeguard good governance are backed up by key pieces of legislation. Following the enactment of the Public Officers Ethics Bill - which provides a code of conduct for all public officers, including Members of Parliament, the executive and the judiciary - in mid-2003, mechanisms were instituted for implementing the Act. All public officials, including members of the judiciary, executive, and legislature, were required to complete declarations of their assets and those of their families by December 2003, and the information declared therein will be made public. An independent Anti-Corruption Commission was established in 2004 to investigate alleged cases of corruption. In addition to this, reforms to the judicial system were made which included the dismissal of corrupt judges. In spite of these efforts, there is a perception that the political resolve to fight corruption is rather uncertain.

The government has increased funding for pro-poor social services especially in health and education. The share of government health expenditure in total expenditure increased to 5.3 per cent in 2004 from 5 per cent in 2003. Nonetheless, the 2003 Kenya Demographic and Health Survey (2003 KDHS) shows that the health situation remains dire. The infant mortality rate (77 deaths per 1000 live births) and under-five mortality rate (115 deaths per 1000 live births) are very high, as are pregnancy-related deaths (14 per cent of all deaths of women aged 15-49), possibly due to the high proportion of deliveries that take place without the assistance of professional medical personnel. Total Fertility Rate (TFR), which declined between the 1960s and the 1990s, seems to have started rising again since 1998. This represents a major demographic challenge for a country that already has one of the fastest growing population rates in Africa. Domestic violence also appears to be an important issue.

The spread of HIV/AIDS continues to represent a major challenge to the health system although the HIV prevalence rate has slowed down. The infection rate among females is higher than among males.

Government expenditure on education, which rose sharply to 21.4 per cent of total expenditure in 2003, fell to 20.8 per cent the following year. The introduction in 2003 of free primary education enabled over one million children who previously received no formal education to enrol in primary school. However, the "hard-to-reach" group of youngsters that includes street children, orphans and those with HIV/AIDS, require specific measures if the country is to achieve its education for all objective. The increase in primary school enrolment will need to be followed by improvements in the higher levels of the education system.

Madagascar



key figures

- Land area, thousands of km² 587
- Population, thousands (2004) 17 901
- GDP per capita, $ (2003) 315
- Life expectancy (2000-2005) 53.6
- Illiteracy rate (2004) 30.3

THE INDIAN OCEAN ISLAND OF MADAGASCAR belongs to the low revenue group of countries. GDP progressed rapidly between 1997 and 2001, growing at an average 4.5 per cent following the launch of a rigorous stabilisation and structural adjustment programme in collaboration with the IMF and the World Bank. Because of the lack of appropriate redistribution measures, the consequences of this improvement have not always made themselves felt in the rural areas. The country is still plagued by problems of governance, and isolation caused by the inadequacy of economic infrastructures accentuates the poverty of the island's population.

Following the political crisis of 2002, the country suffered a grave recession, marked by a negative growth rate of -12 per cent. This situation worsened the poverty from which 80 per cent of Malagasies now suffer, compared with 71 per cent in 2001. Once the political situation had stabilised, the new government took measures to stimulate economic activity and social development. A series of reforms was initiated including, notably, rehabilitation of road infrastructures to open up isolated regions, and reform of the education and health sectors. Since then, the country has witnessed a recovery in real GDP: the year 2003 was marked by a growth rate of 9.8 per cent. In 2004, despite the sharp depreciation of the Malagasy franc (which lost 50 per cent of its value in relation to the euro), the economy maintained a growth rate of 5.3 per cent. For 2005, a growth rate of 6 per cent is expected.

Growth has remained robust and macroeconomic stability has been restored despite two major cyclones and 50 per cent depreciation.

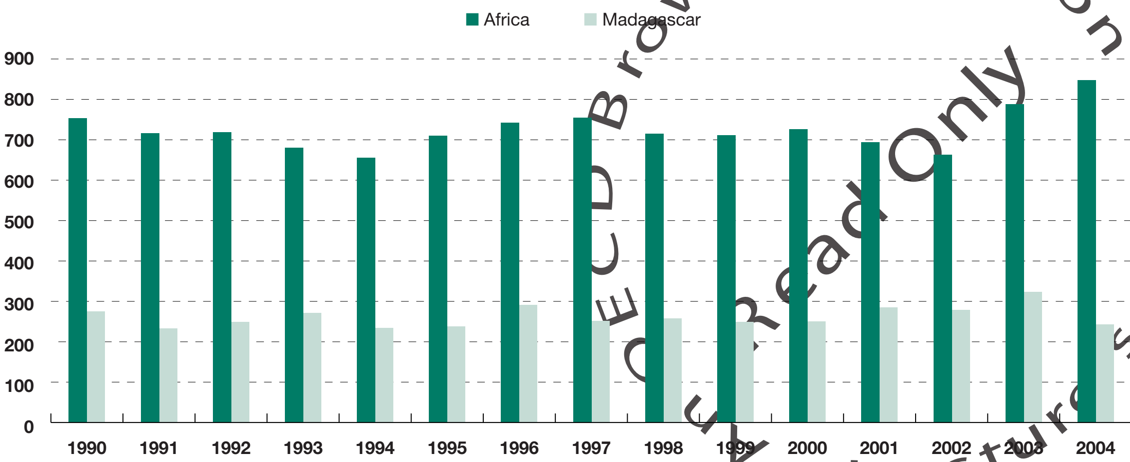
Recent Economic Developments

Figure 1 - Real GDP growth

Source: National Statistical Institute data; estimates (e) and projections (p) based on authors' calculations.

In the course of 2003 the Malagasy economy emerged from the recession of the previous year into a recovery that exceeded growth targets. Economic results in 2004 were heavily influenced by two exogenous factors that led to a fall in the growth rate in relation to that of 2003. These were the violent cyclones Elita and Gafilo that struck the country in the first quarter, and the rise in the price of oil on the international market. Despite these problems, the efforts made over the last two years to stimulate production have borne fruit. In 2004, the recovery continued and the 5.3 per cent economic growth rate was well above the 2.8 per cent demographic growth rate. This growth is supported

Figure 2 - **GDP per capita in Madagascar and Africa** (current $)



Source: IMF.

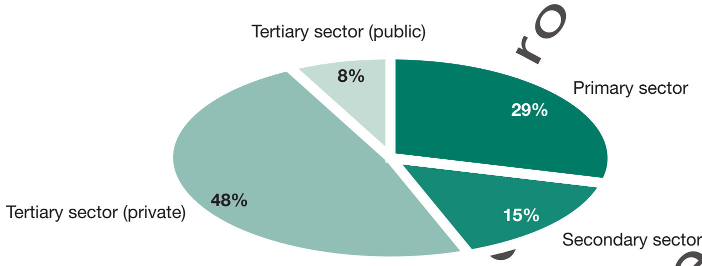
as much by public as by private sector investment. The investment level rose from 16.2 per cent of GDP in 2003 to 22.4 per cent in 2004. Despite these recent economic improvements, the population's living conditions remain precarious. Two thirds of the inhabitants of Madagascar live below the poverty line – 80 per cent in the rural areas and 55 per cent in urban areas – and more than 60 per cent suffer from malnutrition. The country's GDP per capita remains one of the lowest on the continent. The government aim is to bring poverty down to its 2001 level, at least in terms of well-being.

In 2003, the primary sector constituted 28.9 per cent of GDP. It is currently going through a recovery characterised by an annual growth rate that has risen from 1.3 per cent in 2003 to 3.6 per cent in 2004. This recovery follows the introduction of a series of measures designed to stimulate the economy such as the abolition of taxes on fertilisers, inputs and agricultural equipment, the implementation of rural development programmes, and the introduction of agricultural aid. This sector is driven by agriculture, which, employing 80 per cent of the working population and contributing an annual average of 17 per cent of GDP, is the cornerstone of the Malagasy economy.

Following the stagnation that marked 2002, the agricultural sector grew by 2.6 per cent in 2003. This recovery continued in 2004 when estimated growth was 3.5 per cent. These results are due to the development of food production, principally rice paddy, corn, manioc, potatoes and sweet potatoes, and to the development of export products such as coffee, vanilla, pepper, cloves and lychees. In addition to these programmes and measures, good climatic conditions have also stimulated agricultural performance. Estimated rice production in the 2002/03 season was 2 799 281 tonnes of paddy, which was a 7 per cent increase on the previous year's harvest. Despite an expected 200 000 tonne increase in rice production to 3 million tonnes in 2004, producers remain unable to satisfy local demand for a product which constitutes the staple food of the Malagasy people. Rice imports were expected to be about 100 000 tonnes in 2004, but the real import requirement may have been higher than that because of the scale of damage caused by the cyclones in the rice paddy plantations at the start of the year. The rise in world rice prices, which moved up from $180 to $200 per tonne in previous years to $300 per tonne in 2004, coupled with the weakness of the Malagasy franc (MGF), has increased import costs. Rice prices have taken off despite the fact that "government rice" is still sold at 3 500 MGF per kilo. On the demand side, the market has not moved significantly. On average, a Malagasy consumes 129 kg of rice per year and the government hopes that demand will rise to 145 kg per year as its poverty reduction programme improves the purchasing power of the less well off.

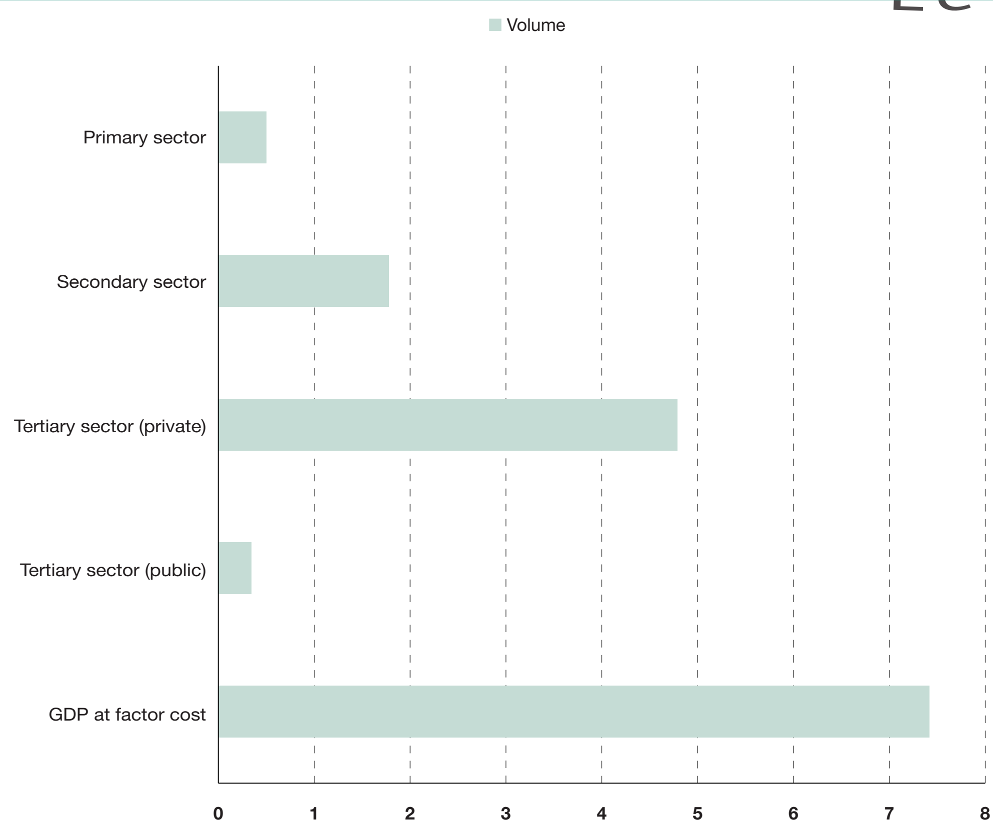
In terms of volume coffee occupies a major place among export crops. In 2003, production was estimated

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: National Statistical Institute; projections based on authors' calculations.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: National Statistical Institute; projections based on authors' calculations.

to be up 47.9 per cent on 2002 at 95 239 tonnes. Coffee exports rose from 7 100 tonnes in 2003 to 10 100 tonnes in 2004, with 12 700 tonnes forecast for 2005. Three provinces account for 97.2 per cent of production. They are Fianarantsoa (59.9 per cent), Antsiranana (21.2 per cent) and Toamasina (16.1 per cent). Vanilla, the country's second biggest export crop, fell from 1 000 tonnes exported in 2003 to 700 tonnes in 2004. This fall in production is the result of the destruction of plantations in the SAVA region (Sambava, Antalaha, Vohémar and Andapa) during the passage of cyclone Huddah in 2001. The new liana planted in 2002 will not give fruit for three years. Vanilla gave good returns to planters in 2003, with green vanilla being sold, on average, at over 300 000 MGF. The same cannot be said for Arabica coffee, the price of which remained low throughout the period from 2001 to 2004.

Livestock and fishing together contributed 8.2 per cent to GDP in 2003. Their growth rate nearly doubled between 2002 and 2003, rising from 2.6 to 4.1 per cent. The national cattle herd consisted of 8 020 449 animals in 2003, as against 7 877 073 in 2003, which represents an increase of 1.8 per cent. This improvement is due to technical support measures for animal production such as artificial insemination and cattle vaccination.

The fishing/aquaculture sector represented 7 per cent of GDP in 2003. It accounted for 24 per cent of total exports. Annual fish availability, including all species, is estimated to be between 6 and 6.9 kg per capita. In the context of the development of fishing and fish resources, the performances achieved in 2003 were based on the development of the production of both sea and inland fishing. Prospects for the years 2004 and 2005 indicate that there will be a fall in growth in 2004 to 3.2 per cent followed by a small increase in 2005 to 3.5 per cent.

Concerning efforts to conserve the quantity and quality of natural resources, the level of recovery of forest resources improved following an administrative check on exports of forest products in 2002. In the case of ebony, for example, this resulted in an increase in revenue from 164 580 469 MGF in 2001 to 314 825 535 MGF in 2003. In order to meet the economic, ecological and social needs of the population in forest resources, land and water, 6 232 hectares have been reforested in four regions (East Fénérive, Moramanga-Ambatondraza, and South East and Southern Madagascar).

The secondary sector has seen an improvement since 2002. Starting from a negative growth rate of -20.7 per cent in 2002, growth in 2003 rose to 14.5 per cent. The contribution of the secondary sector to GDP formation also increased. In 2003, the secondary sector contributed about 15.2 per cent of GDP.

The country disposes of great mining potential, which is little exploited. These resources include, among others, gems and collection minerals such as rubies, sapphires and emeralds; quarry materials such as marble; ores such as nickel, titanium and cobalt; industrial minerals such as mica and graphite; and energy resources such as coal, hydrocarbons and chromite. A mining code was drawn up in 1999 to help enable the exploitation of Madagascar's mining potential. The code is based on the disengagement of the state from production activities, the simplification of the mining regime and the provision of incentives for investors. Special fiscal arrangements have been made for mining investments of more than $250 million. These measures include a five-year tax exemption on profits and a guarantee of the right to repatriate funds and reconvert capital. The law also allows for appeals to international arbitration in the event of a dispute between investors and the state.

As for energy cover, a range of programmes are being implemented to improve the population's access to electricity. These include a plan for rural electrification and the development of renewable energies (wood, charcoal etc).

The industrial sector is recovering steadily from the crisis of 2002. As regards the free zones, different measures have been taken by the government, including a revision of the texts regulating the free zones in consultation with the free zone companies and their partners, and a study into the creation of a free zone "observatory". The rate of growth of activity in the free zones, which stood at 75.8 per cent in 2003, fell to 27.9 per cent in 2004. The principal economic activity in the free zones is textiles production, a sector that reaps the benefits of the African Growth Opportunity Act (AGOA). This act has helped the country to improve the competitiveness of its products, which are not subjected to quotas or customs duties when they are exported to the United States. Major American brands now place their orders in Madagascar so as to benefit from these regulations, as well as from the country's low-cost labour. Despite the optimism expressed by the Malagasy authorities, the end of the Multi Fibre Arrangement (MFA) on 1 January 2005 is likely to have a very damaging effect on Madagascar's textile industry. The MFA gave rise to quotas regulating world trade in textile products and clothing. It was thanks to the MFA that Madagascar was able to develop its free zone centred on textiles and clothing production. The end of the MFA is likely to lead to the closure of many factories, as well as causing numerous redundancies. In 2004, numerous factories closed in anticipation of the end of the MFA. In that year alone, there were 5 000 job losses in the textile industry, with 8 000 job losses in the free zone as a whole. It is important, therefore, that strategies be developed to create new activities and to get those hit by unemployment back into jobs.

The development of new information and communication technologies took place in step with that of the free zone companies in the early 1990s. However, Internet use has not progressed as much as was hoped: in 2003, Internet use rose by just 0.7 per cent.

Modernisation of the telecommunications system in Madagascar is very definitely moving forward. All the major cities now have automatic exchanges and all international communications have been automated. TELMA, the national telecommunications company, has been privatised. Competition in the sector has become more intense following the setting up of mobile telephone networks. The number of subscribers in the fixed telephone sector rose from 48 166 in 2001 to 59 688 in 2003. There are now about 50 000 subscribers. The mobile telephone market is currently shared between three private operators – Intercel, Madacom and Orange. The number of subscribers rose from 147 500 in 2001 to 279 548 in 2003. 11 584 people were signed up to Internet services in 2002 – a decrease on the previous year, when 12 500 were signed up. Cybercafés are developing in Antananarivo, and are gradually starting to appear in the provinces as well.

With measures having been taken to develop the sector, tourist activity has been gradually picking up after it was hit by the crisis of 2002. Though tourist arrivals increased in 2003 by 125 per cent over the previous year's levels, they have not yet returned to the levels recorded before the crisis: 170 208 tourists visited Madagascar in 2001. The loss of revenues due to the drop in tourism is about 36 million SDR (the IMF's international reserve asset). Efforts need to be made to promote ecotourism, develop infrastructures and rehabilitate sites and monuments so as to improve the performance of a sector which accounts for 16 per cent of Madagascar's GDP. These efforts, which got underway in 2004, made it possible to attract 110 000 French tourists to the country that same year (a 41 per cent increase on 2003 levels), and will continue in 2005. The Malagasy authorities aim to attract 500 000 tourists annually by 2007. In order to reach this objective, a number of investment projects are in the pipeline including, for example, the expansion of the hotel network and the improvement of the country's airports.

The transport sector played an important role in stimulating the economy in 2003 thanks to investment and maintenance work on the roads, the reinforcement and rehabilitation of the rail infrastructure, the upgrading of ports and inland waterways (the ports of Toliara and Mahajanga were renovated), and the equipment and upgrading of airports (the international

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006 (p)
Gross capital formation	**11.6**	**17.9**	**13.4**	**16.2**	**22.4**	**23.9**	**24.3**
Public	6.7	6.7	3.9	7.2	7.1	7.0	7.0
Private	5.0	11.2	9.5	9.0	15.3	16.9	17.3
Consumption	**93.9**	**89.3**	**95.6**	**97.1**	**95.8**	**92.0**	**91.5**
Public	6.1	8.8	8.4	10.5	9.0	8.9	8.5
Private	87.8	80.4	87.3	86.6	86.7	83.1	82.9
External sector	**-5.5**	**-7.2**	**-9.0**	**-13.3**	**-18.1**	**-16.0**	**-15.8**
Exports	20.5	28.9	16.0	19.9	31.2	33.6	33.7
Imports	-26.0	-36.1	-25.0	-33.3	-49.3	-49.5	-49.5

Source: National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

airport was extended and renovated and new equipment was installed at Ivato airport). Freight transport contributed 18.6 per cent to the creation of added value in the services sector - about 9.6 per cent of GDP - in 2003. Passenger transport showed 13 per cent growth in 2003 after a 35.4 per cent shrinkage in 2002, while the auxiliary transport branch grew by 15.7 per cent in 2003 after a 21.1 per cent fall in 2002. In 2004, growth rates for these three branches are expected to be 5.6 per cent, 6.3 per cent and 5.4 per cent respectively.

Gross fixed capital formation fell to the extremely low level of 13.4 per cent of GDP during the crisis of 2002. Since this difficult period there has been a regular progression in gross formation of fixed capital (both public and private). This trend looks set to be pursued in the coming years, though the government will need to take steps to attract foreign investors and develop the private sector.

Macroeconomic Policies

Fiscal and Monetary Policy

The authorities have recognised the influence of taxation on the economy as a whole and have launched a reform to improve tax recovery and efficiency. Two systems cover company taxation: the common law system, which applies to all operations on the local market, and the free zone preferential system, which is uniquely for export companies. Under the common law system, the state grants investments a number of exemptions from tax and duties. Under the industrial free zone regime, more far-reaching incentive measures are applicable: 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 value added tax) on equipment.

In 2004, a number of major fiscal reforms were introduced to the law governing finance. They included, notably, a reduction in the highest rate of customs duty from 35 to 20 per cent, and a certain number of adjustments to customs rates. These changes included an increase in certain taxes on imported goods - including both raw materials and finished consumer goods.

Following the crisis in 2002 the government decided to increase public spending so as to be able to pursue its recovery programme and implement its poverty reduction programme. Investment spending thus progressed strongly from 5 per cent of GDP in 2002 to more than 11 per cent in 2004.

In 2003, the monetary authorities managed to hold down inflation by implementing a restrictive monetary policy. During the first nine months of 2004, however, inflation was again very high, reaching 22 per cent by the end of September as a result of the sharp increase

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue[a]	**12.4**	**14.0**	**10.2**	**15.4**	**19.6**	**19.1**	**18.3**
Tax revenue	8.2	9.7	7.7	10.0	11.1	11.0	11.1
Oil revenue	4.2	3.9	2.2	5.1	7.8	7.3	6.4
Total expenditure[a]	**17.8**	**18.4**	**15.7**	**19.5**	**22.9**	**22.1**	**21.3**
Current expenditure	10.5	11.1	10.9	11.7	11.5	10.7	10.0
Excluding Interest	*5.8*	*9.1*	*8.7*	*9.5*	*8.5*	*8.3*	*8.0*
Wages and salaries	3.2	4.5	4.6	5.4	4.8	4.7	4.5
Interest	4.7	2.0	2.2	2.2	3.0	2.4	2.0
Capital expenditure	7.3	7.3	4.8	7.8	11.4	11.3	11.3
Primary balance	**-0.7**	**-2.4**	**-3.3**	**-1.9**	**-0.3**	**-0.6**	**-1.0**
Overall balance	**-5.4**	**-4.3**	**-5.5**	**-4.1**	**-3.3**	**-3.0**	**-3.0**

a. Only major items are reported.

Source: National Statistics Institute data; estimates (e) and projections (p) based on authors' calculations.

in the price of rice and oil products. To contain inflation, the authorities pursued a rigorous monetary and budgetary policy, which succeeded in stabilising inflation – excluding oil products and rice – at 6 per cent from the end of June 2004. The Central Bank raised its main interest rates and its compulsory reserves levels. At the same time, the government facilitated the importation of low cost rice.

The interbank currency market (MID), which was set up in 1994, sets rate of exchange between the Malagasy franc and foreign currencies. The foreign exchange market is governed by a convention between the commercial banks and the central bank. The Malagasy franc fell by about 50 per cent in value against the euro during the first five months of 2004. These changes called into question the wisdom of the duty reduction introduced in 2003, which artificially boosted imports causing a shortage of foreign currency. Since June 2004, the exchange market has been relatively stable.

External position

Madagascar is developing an active external policy that aims to increase its exports and bring in the currency and resources it needs for development. In 2003, exports increased 63 per cent in SDR terms. Madagascar's principal customers are the European Union countries, which account for 42 per cent of its exports by value. France is by far the country's leading trading partner. French companies are the leading foreign investors, representing 60 per cent of all foreign investment. Exports destined for the United States are showing regular growth and increased 26.1 per cent in 2003. Madagascar's imports, which come mainly from France, increased by 70.3 per cent between 2002 and 2003. In 2004 they are expected to have increased 8.5 per cent. Overall, imports increased more rapidly than exports, resulting in a balance of payments deficit of 234.7 million SDR or about 5 per cent of GDP in 2003 – the same as in 2002. The 2004 deficit is expected to be 8 per cent of GDP.

In 2004, the government pursued its policy of integrating the Malagasy economy into that of the sub-region and of the world at large. Efforts are being made – for instance through Madagascar's joining of the Southern African Development Community (SADC) in August 2004 – to promote regional integration with a view to the launch of the customs union of the Common Market of Eastern and Southern Africa (COMESA) and to respect WTO rules. The country is participating in globalisation, whilst also signing up to regional and international agreements. By signing a number of different international agreements Madagascar is gaining preferential access to various external markets, notably: *i)* to Europe via the Cotonou agreement and the Everything But Arms initiative between the European Union and ACP (African, Caribbean and Pacific) group of states; *ii)* to industrial countries generally through the Generalised System of Preferences (GSP); *iii)* to the neighbouring region, to member countries of the Indian Ocean Commission (COI) and COMESA; *iv)* and to the United States through Madagascar's eligibility for the African Growth and Opportunity Act.

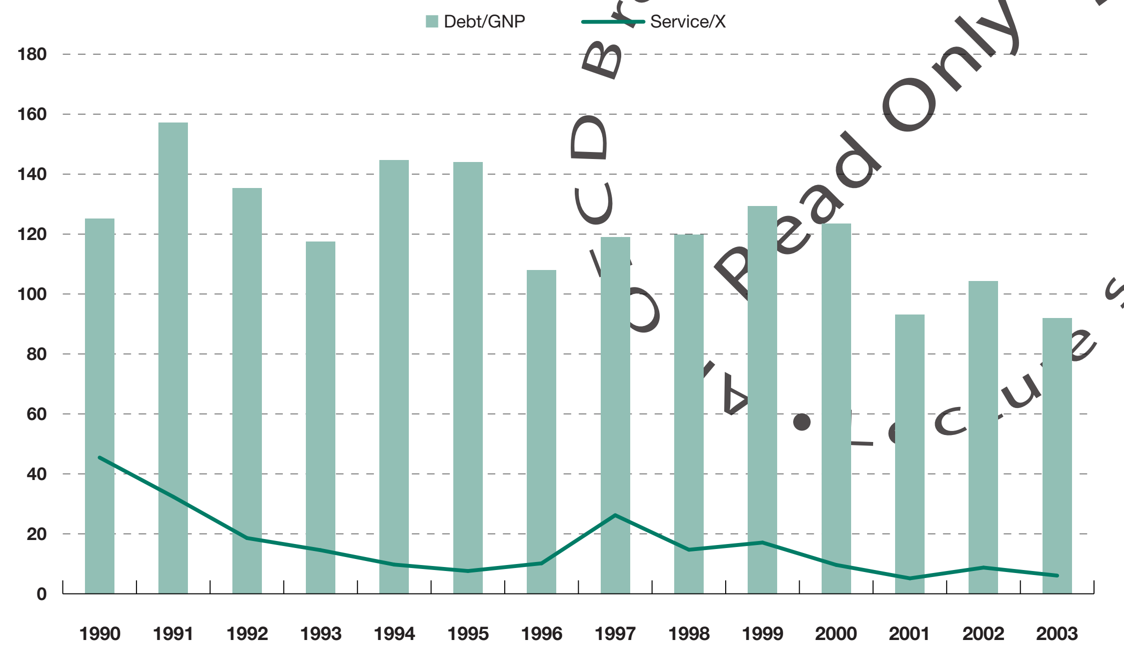
With regard to external debt, Madagascar has benefited from the initiative in favour of heavily indebted poor countries (HIPC). Its arrival at completion point

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-3.0	0.3	-1.1	-4.0	-8.9	-9.4	-8.9
Exports of goods (f.o.b.)	13.1	21.3	11.0	14.4	21.0	20.7	21.1
Imports of goods (f.o.b.)	-16.1	-21.0	-12.0	-18.5	-29.8	-30.2	-30.0
Services	-2.1	-3.5	-3.9	-4.0			
Factor income	-3.6	-1.3	-1.5	-1.5			
Current transfers	2.8	3.2	2.2	4.5			
Current account balance	**-6.0**	**-1.3**	**-5.9**	**-5.0**			

Source: National Statistical Institute data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of export)



Source: World Bank.

in October 2004 qualified it for the cancellation of half of its debt, representing about $2 billion.

Structural Issues

Madagascar's economy is strongly based on the informal sector. Its regions are for the most part isolated and road infrastructures are still very underdeveloped. The Malagasy authorities are committed to reforms that should in the long-term foster development of the private sector.

The government has taken measures aimed at improving the business climate and, above all, at contributing to the creation and development of small and medium-sized companies (SMEs). In its strategic programme, the Ministry of Industrialisation, Commerce and Private Sector Development identified several spheres of action, such as the reform and development of the financial system through the development of new methods of financing; encouragement of initiative, particularly through the development of sectors such as tourism, micro-companies and crafts; support for companies through a regional approach to their development, and the encouragement of new skills; better dialogue between the state and the private sector; and the development of support services for private companies. In the micro-finance sector, three types of organisation exist: *i)* membership based bodies or mutualist financial institutions belonging to the professional association of mutualist financial associations (APFIM), set up in 1998; *ii)* direct credit bodies non-mutualist financial institutions belonging to the association of micro-finance institutions (AIM), which was set up in 1999; *iii)* projects which have a loans section and the NGOs and other associations for which lending is not the principal activity.

The donors also provide support for the development of micro-finance. The principle players are the World Bank – through its micro finance project administered by the AGEPMF, a specially created association –, the *Agence française de développement*, the European Union, the International Fund for Agricultural Development, the African Development Bank and United Nations

Development Programme (UNDP).

The current Malagasy government is pursuing a policy of state disengagement from productive economic activity. The privatisation process is gradual, and rather slow. In August 2003, the Malagasy government and the DISTACOM telecommunications company signed a contract for the sale of the fixed telephone services supplier, TELMA. The water and electricity services are also in the process of being privatised. The call for tenders for the sugar company, SIRAMA, was cancelled in 2003 because of procedural irregularities. At the end of June 2004, the performance criteria for the tender call were met. The privatisation of the cotton company, HASYMA, was completed in October 2004.

The level of infrastructures in Madagascar remains painfully low, with the regions of the main island still very isolated. The Malagasy road network extends over 25 500 km, of which just 5 500 km are surfaced. Since road construction and rehabilitation is one of the government's priorities, the state has set itself the task of decentralising construction and repair work, and of maintaining a priority network of 15 000 km linking the country's different the regions. The government has also taken on the job of rehabilitating and maintaining 1 189 km of roads serving the six provincial capitals. It plans to pursue the rehabilitation of road infrastructures in future years and to carry out work to reduce the isolation of the most remote areas.

On the 870 km long Malagasy rail network, the dilapidation of fixed infrastructures and rolling stock are holding back traffic development. A concession for the northern network was awarded to the COMAZAR group in 1997. A local company called MADARAIL has been charged with operating the network for the next 25 years and is planning to invest $35 million in track and rolling stock.

Madagascar has 12 main airports, 5 of which are international. These are run by *Aéroports de Madagascar* (ADEMA), 33 per cent of which is owned by the Paris airport company, ADP. The possibility of delegating the management of the Antananarivo international airport is currently being studied. In maritime transport, the country has 18 ports, 12 of which are local, and 6 international, together they play a very important role in serving the needs of the isolated regions.

Within the framework of public sector reform, particular emphasis has been put on promotion of the private sector, good governance and the fight against corruption (for which a special upper council has been created). Modernisation of public finances should help the system cope with the new priority given to budget aid by the country's financial partners. The absorption of the public investment department into the public spending department will facilitate the rationalisation of budget drafting. This merger should make it possible to draft a consolidated budget, which will include off balance operations, balance and investment - including

Small and Medium-sized Companies in Madagascar

In Madagascar, small and medium-sized companies are defined as companies which have an investment level of between 5 000 and 50 000 euros. There were 15 000 of them in 2002 and 13 000 in 2003, as the effects of the political crisis of the previous year took its toll. About 90 per cent of SMEs are located in the capital and its surrounding area. More than 50 per cent of them are informal. The support committee for company revitalisation, which was set up in the wake of the crisis, has opened talks on the customs system and other regulatory texts so as to draw people's attention to the development of SMEs. The committee noted that there was no system for financing of this type of company. It recommended state support for the creation of a fund to promote the creation of small companies, for training in entrepreneurship and for the creation of a favourable business environment through simplification of administrative procedures, improvement of infrastructures and so on. It was intended that these measures complement existing aids to SMEs, such as the credit lines offered by certain financial institutions.

public debt - and will strengthen the public spending department. The whole process of putting the budget into effect will be computerised so as to cut out slow and cumbersome administrative procedures and increase transparency. This reform was due to be completed by the end of 2004.

The reform of public finances is one of the principle measures in the drive to establish good governance. It involves the strengthening of budget procedures and a rationalisation of the system controlling the execution of the state budget. In 2004, the government set up in 2004 a committee to look at ways of bringing down public spending (CRROC), it was charged with restructuring the briefs and the workings of the bodies responsible for controlling the regularity of state spending. As for state revenue, the level of fiscal pressure in Madagascar is among the lowest in Sub-Saharan Africa. One of the government's priorities is to guarantee tax and customs revenues by reforming the general organisation of the relevant services and strengthening their capacity. A new system of customs control before embarkation was adopted in 2002.

Political and Social Context

Following the 2001 presidential elections, Madagascar went through a deep political crisis, which led to a regime change. The new government was only able to take office after several months of further political crisis and major social upheaval. These problems threw the country's economic and social life into disarray: the freedom of movement of goods and persons was inhibited which led to an economic slowdown. This caused lay-offs, company closures and an explosion in prices resulting from shortages of rice and numerous other essential commodities. Despite the country's current stability, the risk of conflict remains as was illustrated by the political exploitation of the rice shortage in November 2004.

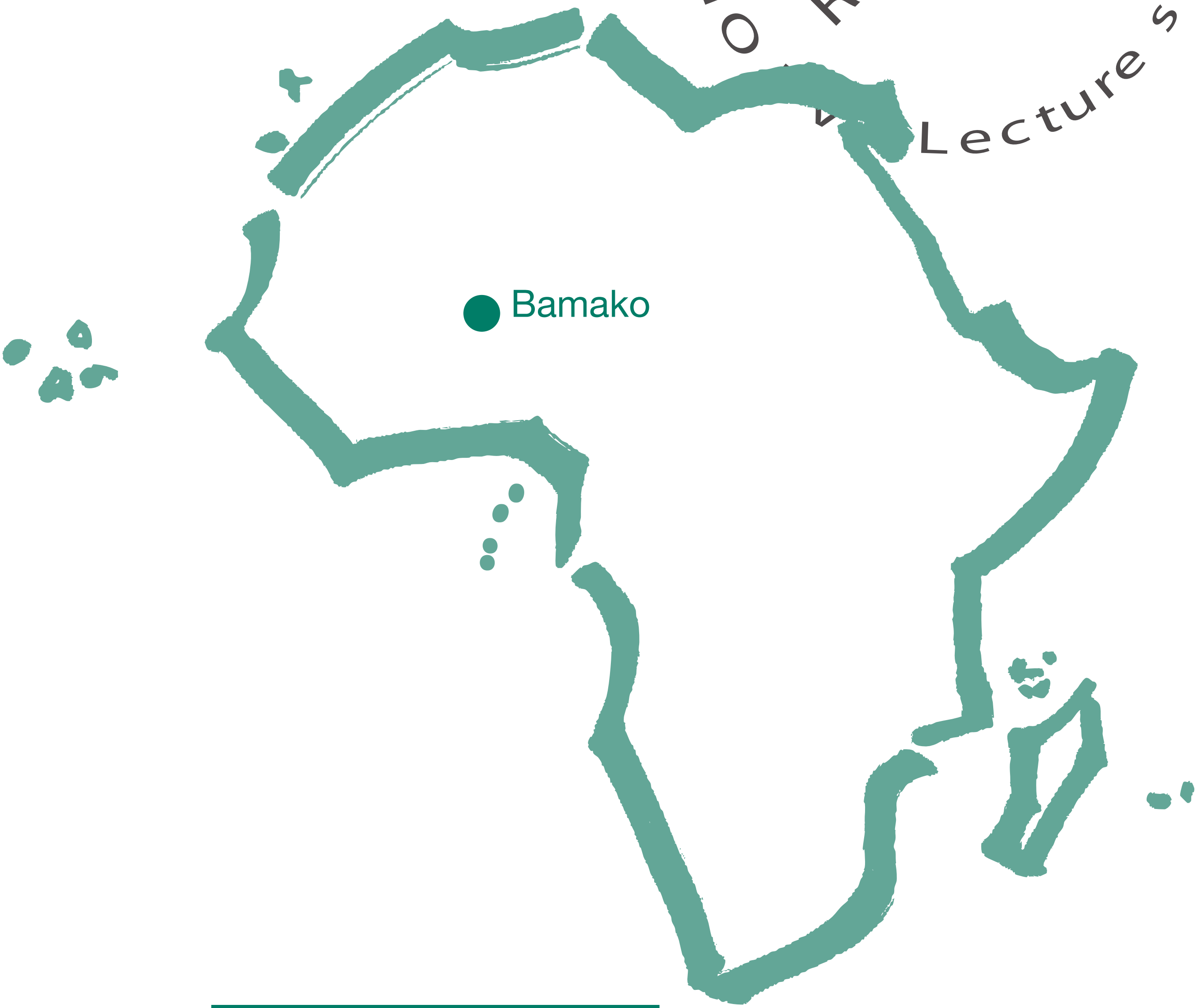
In the first half of 2003, the Malagasy government adopted a poverty reduction strategy document outlining the measures needed to accelerate the country's development and reduce -over 10 years - the poverty which affects 70 per cent of the population, particularly in the rural areas. One of the major principles underlying this strategy is restoration of the rule of law and good governance. The fight against corruption is considered to be one of the fundamental requirements for the establishment of good governance. To this effect, a high-level council for the fight against corruption was set up in September 2002 under the direct authority of the President of the Republic. Its mission is to develop a national strategy to fight corruption. On 20 July 2004, the first national convention for the fight against corruption was held and an anti-corruption law was adopted on 9 September 2004. The aim, apart from prosecution in proven cases of corruption, is to carry out the necessary reforms, notably through a strengthening of existing anti-corruption efforts, the creation of single point reception facilities and the opening of complaints logs for users of public services, the reduction of corrupt practices and favouritism in the civil service, the simplification of texts dealing with conduct, professional behaviour and ethics, and the intensification of information campaigns, education and communication, including, notably, the reintroduction of civil instruction into schools. In the past corruption offences have generally gone unpunished, but now the legislator has given the judicial system specially designed tools to fight this scourge.

A number of new measures have been taken in the field of local and territorial development; these include the support programme for neighbourhood initiatives (PAIQ) and the regional development programme. In 2004, the government equipped local authorities with typewriters and bicycles. In 2005, it will be concentrating on the provision of safes. The state has built mayoral offices in the 166 new local authorities that emerged after the last local elections. The discussions between donors and the office of the Secretary of State for Decentralisation and Regional and Local Development (SEDDRC) on questions concerning decentralisation and local development (which took place in a working group which was particularly active from January 2003 to January 2004), are indicative of the interest this question attracts. The principal current challenge for the state – and in particular for the SEDDRC – is to set up a rigorous framework into which can be inserted all the initiatives taken to support the regions and local councils.

Madagascar's gross mortality rate stands at 12.1 per 1 000 and its birth rate at 40.7 per 1 000. The infant mortality rate is 84 per 1000. In the health care field, there is one hospital bed for every 2 000 inhabitants and one doctor for every 10 000 inhabitants. Access to health care is estimated at 30 per cent in rural areas and 70 per cent in urban areas. In 2001, 47 per cent of the population had access to drinking water – 85 per cent in urban areas and 31 per cent in rural areas. Various improvements were seen in 2003 and were due to continue in 2004. Healthcare indicators are improving. Attendance levels at basic community health centres rose from 84.3 per cent in 2002 to 87.1 per cent in 2003 and the level of DTC 3 vaccination cover for children aged 0 to 11 months rose from 61.5 per cent in 2002 to 80 per cent in 2003. The year 2004 was devoted to the consolidation of advances already made. Measures taken consisted of increasing the numbers of medical personnel, distributing material and equipment, building and rehabilitating health care centres and providing care for deprived sections of the population.

In education, implementation of the "education for all" policy increased the proportion of children attending school from 70 per cent in 2002 to 82 per cent in 2003 and the level of completion of primary school from 35 to 39.5 per cent over the same years. The success rate in the CEPE, BEPC and *Baccalauréat* exams also improved, thanks, notably, to an increase in teachers' numbers and improvements in training, as well as the provision of teacher training manuals and school books. In 2004, school kits continued to be supplied to children in the first year of primary education.

Mali



key figures

• Land area, thousands of km²	1 240
• Population, thousands (2004)	13 409
• GDP per capita, $ (2003)	324
• Life expectancy (2000-2005)	48.6
• Illiteracy rate (2004)	71.3

THERE ARE CONSIDERABLE CONSTRAINTS holding back economic development and the reduction of poverty in Mali. The crisis in Côte d'Ivoire highlighted the problems caused by the country's hemmed-in position, while current tensions between the government and the private concessionaire responsible for electricity production underline the more general difficulty the cost of factors represents for the domestic economy. High factor cost, in a context of strong international competition, renders difficult the development of conversion activities such as textiles. The financial system is under-developed and does not allow the financing and thus the emergence and development of a tissue of dynamic, employment-generating, small and medium-sized companies (SMEs). These economic constraints are compounded by social factors such as the lack of qualified labour, illiteracy and poor health. The population is therefore very exposed, and this vulnerability renders difficult the implementation of important structural reform. The decision taken in 2004 to postpone until 2008 deregulation of the cotton sector is an instructive example of the constraints weighing on government decisions in this area.

Limited diversification led to penalisation from the fall in cotton prices.

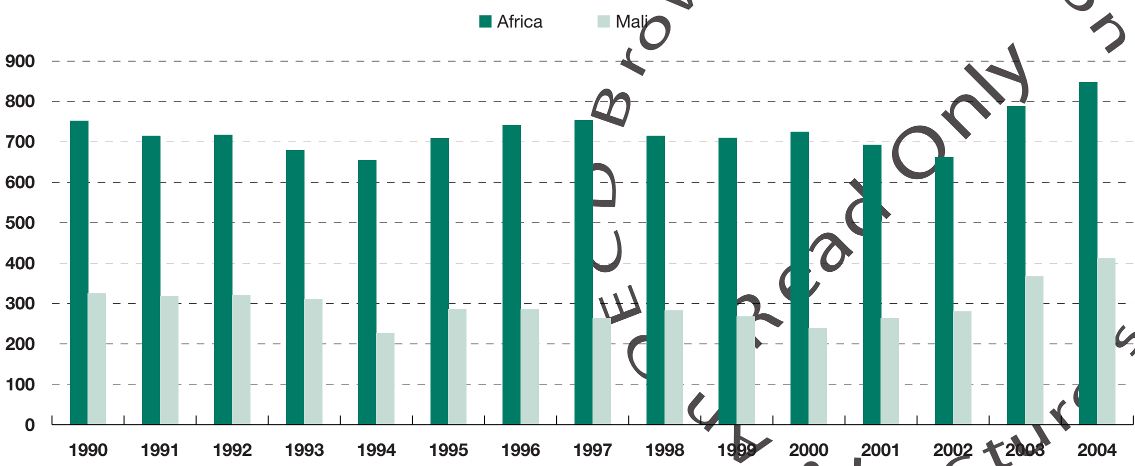
Owing to these unfavourable conditions, Mali's economy remains under-diversified, it creates little added value, and the country is still over-dependent on cotton, agriculture in general, and gold. It is therefore very exposed to exogenous factors such as the price of raw materials, the euro and dollar exchange rate, the price of oil, the climate, and plant disease and pests. The unfavourable combination of these different factors (with the exception of the price of gold) in 2004 resulted in estimated growth of 2.2 per cent, much less than in 2003 when growth was 7.4 per cent. In 2005, it is likely that the sharp fall in the price of cotton will weigh heavily on the performance of the cotton sector and oblige the government to provide massive subsidies for the public sector cotton company. Growth should nevertheless recover to reach 5.7 per cent in 2005 and 5.9 per cent in 2006.

Despite these problems, the country has a number of assets. As well as having extensive underground reserves of gold, limestone, clay and perhaps oil, and substantial resources in such domains as livestock and agriculture (market gardening), Mali has a peaceful

Figure 1 - Real GDP Growth

Source: *Direction nationale de la statistique et de l'informatique* data; estimates (e) and projections (p) based on authors' calculations.

Figure 2 - **GDP Per Capita in Mali and in Africa** (current $)



Source: IMF.

and consensual political and social climate and its public policies are well-orientated and producing improvements in budgetary performance, poverty, transport and the business environment. Mali has good relations with its development partners, as was demonstrated by the donor meeting in Geneva in March 2004 which was devoted to the strategic framework of the fight against poverty. However, the progress made – and the country's advantages – are probably not yet equal to the challenges facing Mali in terms of employment, diversification and poverty reduction. This means that the government must pursue its efforts to make its policies more rigorous and efficient, whether this be in budgetary programming, or the application and management of its policies to combat poverty. Finally, the desire to preserve social cohesion and political consensus must not lead to the postponement of difficult but vital decisions, some of which have already been long-delayed, as is the case, for example, in the cotton sector.

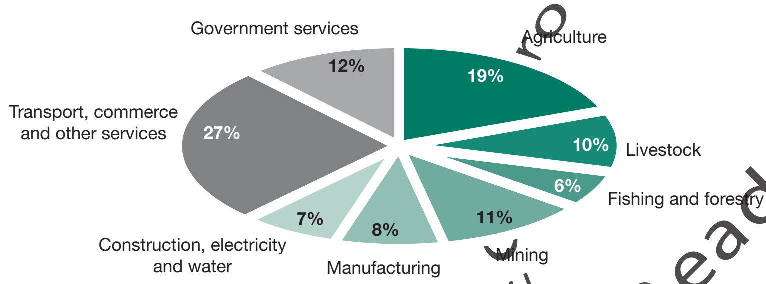
Recent Economic Developments

The Malian economy depends mainly on the primary sector, which employs about 70 per cent of the working population and produced 35 per cent of GDP in 2003. The sector's performance therefore determines the dynamism of the economy as a whole. In this respect, 2004 was not a very successful year because the sector registered an estimated 4.7 per cent contraction, principally due to a fall in cereal production and, to a lesser extent, to a slight reduction in the cotton harvest.

The cotton sector plays a driving role in Mali. It contributes about 8 per cent of the country's GDP and about 3.3 million people live directly from its cultivation. Cotton also plays an essential role in the development of rural infrastructures, social and health services, and encourages the cultivation of cereals that use a share of the inputs required for cotton cultivation. Cottonseed production remained high in 2004/05 at 617 000 tonnes, as against 625 000 tonnes in 2003/04. Given the fall in world prices since the middle of 2004, this production will probably be sold on the world market at a price well below the 210 CFA francs/kg price negotiated between the state purchasing, ginning and marketing monopoly, the national textile company (CMDT), and producers for the 2004/05 harvest. As a result, CMDT could register a loss of 70 billion CFA francs ($132.2 million) on the sale of the 2004/05 crop.

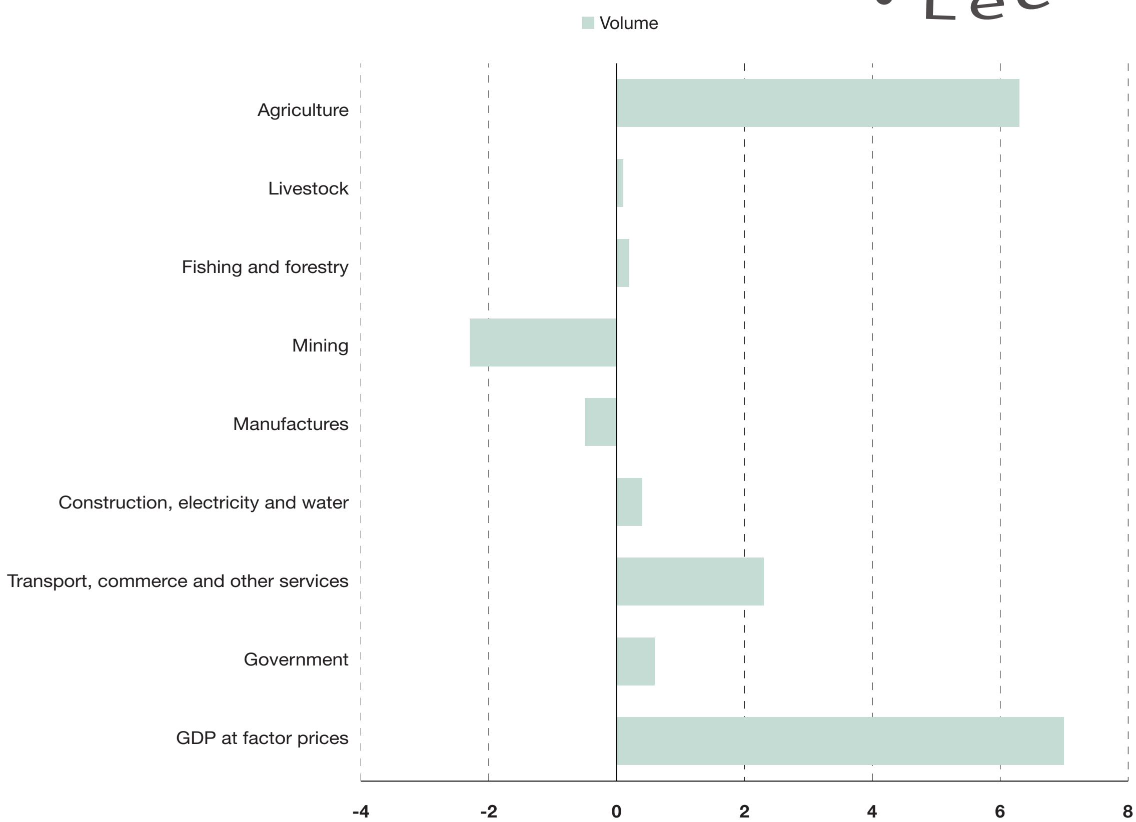
This situation raises once again the difficulty of establishing a purchase price mechanism that guarantees producers a minimum price that will cover their production costs while reflecting – at least partially – movements in international prices. The price mechanism was reformed in 2002 – following the 2000/01 crisis – in an attempt to reconcile two objectives that are at loggerheads when movements in world prices are

Figure 3 - **GDP by Sector in 2003** (in percentage)



Source: Authors' estimates based on *Direction Nationale de la Statistique et de l'Informatique* data.

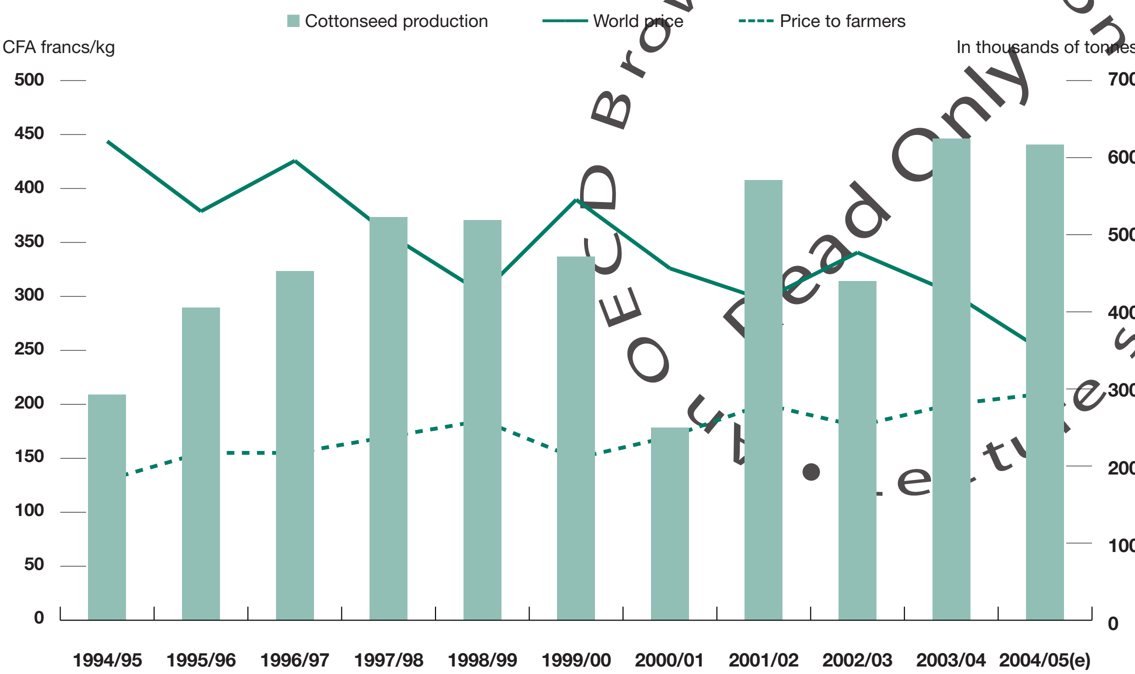
Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (in percentage)



Source: Authors' estimates based on *Direction Nationale de la Statistique et de l'Informatique* data.

unfavourable. The two pillars of this system, a rebate mechanism indexed on the commercial results of the previous season and a stabilisation fund (which has remained without funds) did not function, however. Producer prices are still fixed through negotiations – which are often bitter and largely disconnected from movements in international prices – between the CMDT and producers. The government, while refusing to reconsider the 2004/05 producer price of 210 CFA francs/kg, has committed itself to setting up a new price mechanism that will take account of movements in international prices for the 2005/06 season. The price proposed in April 2005 is expected to be between 160 and 175 CFA francs/kg, but it could be lowered

Figure 5 - **Cotton Production and Prices in Mali**



Note: Production and prices to growers refer to cottonseed on a crop period basis. The international price is for cotton fibre, so it has been converted into the equivalent of cottonseed at a conversion rate of 42 per cent and calculated as a calendar year average (year n+1 for a crop in n/n+1).

Source: *Direction nationale de la statistique et de l'informatique* and World Bank.

in August 2005 to take account of movements in the international price. The authorities, aware of the unpopularity of this measure and anxious to avoid a production strike like the one in 2000/01, have committed themselves to carrying out a vast information campaign on the ground. A sharp drop in production in 2005/06 cannot be ruled out, however.

Cereal production in 2004/05 has been estimated at 3.2 million tonnes (with consumption needs estimated at 2.6 million tonnes), compared to 3.6 million tonnes in 2003/04. This drop in production of about 10.7 per cent is primarily due to insufficient rainfall and, to a lesser extent, to locust infestation. The impact of the latter should not be overestimated, however: Kayes, Gao, Tombouctou and Mopti were ravaged by the swarm, but the principal cereal production zones - Sikasso and the region covered by the Upper Niger Valley Authority (OHVN) - were spared. Rice production was also limited by insufficient rainfall - production is estimated to be down about 13 per cent on 2003 levels.

Cotton's high price volatility on international markets underlines the need for Mali to diversify its agricultural activities in order to break out of its dependence on this crop. The country's climate, soil and rainfall are suitable for extending rice and sugar cane production, and also market gardening, particularly in the region managed by the OHVN. Mali already grows tomatoes (it is one of the region's main producers), mangoes, potatoes and French beans, but major efforts need to be made to develop the cultivation and exportation of these crops. The country's potential is vastly underexploited: in the OHVN region, which covers 1 million hectares, only 70 000 hectares of land are irrigated. The development of irrigation is one of the government's priorities. The master plan for the development of the OHVN zone sets as its objective the irrigation of 15 000 additional hectares between 2002 and 2007, reaching 200 000 hectares by 2015. There are also several support projects for the development of export crops, which aim to improve the packaging, conservation and traceability of Malian horticultural products, which are at present notoriously deficient.

Livestock, which represented 10 per cent of GDP in 2003, is the country's third-ranking export sector after gold and cotton. In 2003 the sector was adversely affected by the crisis in Cote d'Ivoire, and growth in that year was at just 1 per cent; production picked up the following year, with growth estimated at 5.5 per cent. The country has a strong agro-pastoral tradition, but the Malian livestock sector remains traditional, nomadic and there is little specialisation. It also suffers from a lack of professionalisation (60 per cent of breeders do not belong to a co-operative) and from the almost complete absence of stock health care. Infrastructures, whether in the form of transport vehicles or abattoirs with refrigeration units, are insufficient. Given these conditions, processing activities have not developed and the country exports mainly live animals, an activity which is much less profitable than the export of meat. The creation of a Ministry of Livestock and Fishing in May 2004 is a sign of the government's determination to modernise this sector.

Gold mining is a relatively recent – but nonetheless key – sector of the Malian economy. It constituted about 57 per cent of exports and 11 per cent of GDP in 2003. It is an important provider of fiscal and non-fiscal revenue for the state. In 2004, production suffered from technical difficulties, particularly at the Morila site, and, as a result, totalled no more than 41.6 million tonnes. Prospecting remains dynamic in Mali, where more than 100 exploration permits are currently in use, and the prospects for investment are good. The exploitation of sites at Kalana, Tabakoto and Loulo should start in 2005 and the authorities' production forecasts for 2005 and 2006 are 47.7 and 58.8 tonnes respectively.

Prospects for the mining of other metals such as iron, bauxite and uranium remain in the very early stages, but oil is quite a different story: Baraka Mali Ventures is going to invest 30 billion CFA francs ($56.7 million) over the next four years in the exploration of five promising sedimentary basins close to the Mauritanian frontier.

The secondary sector (excluding mining industries) - at 15 per cent of GDP in 2003 - holds little sway in the Malian economy: food processing is predominant, accounting for 45 per cent of industrial production. The domestic bias in favour of commerce rather than productive investment; the price of factors; the fact that the country is land-locked; the insufficiency of transport infrastructures; import smuggling; and the lack of qualified labour, are among the reasons why Mali's local industrial fabric is so weak, even when it comes to the processing of local primary products. Less than 1 per cent of cotton is processed locally, the country imports 70 per cent of its construction materials, including cement, despite having plentiful supplies of limestone and clay. There were nevertheless some positive developments in 2004: in textiles, with the opening of Fitina mill and the reopening of the Itema plant; in sugar, with the confirmation that the Markala project will go ahead; and in cement, with the opening of a new production unit under the name of LCM. Most of these projects involve foreign investment but their position is nonetheless rather precarious. The Fitina project is benefiting from a cotton price subsidised by the state via the CMDT, and the end of the multi-fibre agreements on 1 January 2005 will increase the pressure of competition in textiles and reduce the benefits reaped from the African Growth and Opportunity Act[1]. In 2004, the added value created by manufacturing industry progressed 20.9 per cent, compared with 8 per cent in construction and 15 per cent in energy.

The service sector, which made up 39 per cent of GDP in 2003, performed well in 2004, showing growth of about 7.5 per cent, thus softening the fall in growth in the primary sector.

Because of the fall in production in the key sectors of gold and cereals, growth was weaker in 2004 – around 2.2 per cent, compared with 7.4 per cent in 2003. At the same time, demand remained dynamic thanks mainly to public sector consumption and, above all, to private and public sector investment in the form of the industrial projects mentioned earlier. Given the decrease

1. On 11 December 2003, Mali was declared eligible to benefit from the opportunities offered by the AGOA in the fields of textiles and clothing.

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**18.8**	**24.5**	**18.4**	**24.5**	**27.0**	**27.7**	**28.5**
Public	6.9	7.6	7.6	7.2	7.9	8.1	8.2
Private	11.9	16.9	10.9	17.3	19.0	19.7	20.3
Consumption	**96.8**	**83.6**	**82.5**	**83.3**	**81.7**	**83.3**	**83.5**
Public	19.1	15.7	16.2	15.7	17.5	18.0	17.9
Private	77.7	67.9	66.3	67.6	64.2	65.2	65.6
External Sector	**-15.6**	**-8.1**	**-0.9**	**-7.8**	**-8.6**	**-11.0**	**-12.0**
Exports	18.6	26.3	29.0	23.5	24.5	22.5	21.0
Imports	-34.2	-34.3	-29.9	-31.3	-33.1	-33.5	-33.0

Source: *Direction Nationale de la Statistique et de l'Informatique* data; estimates (e) and projections (p) based on authors' calculations.

in cereal production, the high cotton revenues generated in 2003/04 did not succeed in stimulating private sector consumption, which remained stable (with an estimated rise of 0.8 per cent). The contribution of the current balance to growth remained negative in 2004: exports are estimated to have progressed 2.5 per cent, compared to 5 per cent for imports.

Growth prospects for 2005 are uncertain. There could be a recovery in cereals and gold production, while the secondary sector should improve its results thanks to manufacturing industry and ginning of the abundant 2004/05 cotton crop. However, the strength of the euro and a further rise in oil prices could have a negative effect on household consumption. A fall in producer prices could lead to a significant fall in cotton production in 2005/06. Such a development would also have an unfavourable impact on household consumption. The scale of state subsidies which will have to be paid to the CMDT help cope with losses incurred on the sale of the 2004/05 harvest could force a reduction in public spending and, in particular, in public investment, and would lead to a slump in the economy. Growth in 2005 is likely to be at around 5.7 per cent, but is subject to major uncertainties.

Macroeconomic Policies

Fiscal and Monetary Policy

In 2003, Mali respected all the principal requirements set down in the West African Economic and Monetary Union's (WAEMU) convergence, stability, growth and solidarity pact. However, two secondary criteria – the current external deficit excluding grants and the level of fiscal pressure – were not respected, underlining some of the structural problems of the Malian economy, notably the weakness of its export sector and the narrowness of its fiscal base. In 2003 public debt was just one decimal point behind its average level (70 per cent); by the end of 2004 it had risen up to 74 per cent of GDP. The level of fiscal pressure was not more than 15 per cent, as against 14.2 per cent in 2003). Most importantly, the basic budgetary balance over GDP - a "key criteria" - could become negative as the slow-down in growth hits public revenues.

Mali maintains good relations with the International Monetary Fund (IMF), with which it has been engaged since June 2004 in a three-year 9.33 million SDR (IMF international reserve asset) programme of the Poverty Reduction and Growth Facility-type. The first review of the PRGF is planned for early 2005. The programme is going well, although differences with the World Bank over the reform of the cotton sector could prevent it from being executed correctly.

The implementation of the 2004 budget took place in a difficult context. The budget project was based on a projected 4.7 per cent growth: as it turned out, growth did not exceed 2.2 per cent. The objectives set out in the budget had little chance of being achieved, partly due to the slowdown in growth and also because of technical problems encountered in the gold sector. This sector, which brought in 46 billion

Table 2 - Public Finances (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**21.2**	**17.9**	**20.1**	**21.8**	**21.6**	**21.6**	**21.5**
Tax revenue	12.1	12.4	13.4	14.2	15.0	15.3	15.3
Grants	6.8	3.8	3.8	4.6	3.7	3.4	3.3
Total expenditure and net lending[a]	**22.1**	**21.1**	**23.8**	**22.5**	**24.5**	**25.0**	**25.0**
Current expenditure	11.5	13.9	15.0	14.4	15.6	16.0	15.8
Excluding interest	*10.4*	*13.3*	*14.2*	*13.7*	*14.9*	*15.3*	*15.1*
Wages and salaries	3.6	3.9	4.1	4.3	4.5	4.5	4.5
Interest	1.0	0.7	0.8	0.8	0.7	0.7	0.7
Capital expenditure	11.4	7.7	8.9	8.2	9.0	9.2	9.3
Primary balance	**0.2**	**-2.6**	**-2.9**	**0.1**	**-2.1**	**-2.6**	**-2.8**
Overall balance	**-0.8**	**-3.2**	**-3.7**	**-0.7**	**-2.9**	**-3.3**	**-3.5**

a. Only major items are reported.

Source: Ministry of Economy and Finance and IMF data; estimates (e) and projections (p) based on authors' calculations.

CFA francs ($86.9 million) in 2003 in the form of diverse tax revenues and dividends, represents manna for the Malian state (in the form of both tax and dividends). However, because gold production in 2004 was lower than anticipated (at around 41.6 tonnes instead of the expected 48 tonnes), the state could find itself with a revenue shortfall of 15 billion CFA francs ($28.3 million). These problems are compounded by the complexity of relations between the state and the big mining companies that exploit Malian gold. The latter tend to delay paying the advances on dividends due to the state. In November 2004, out of 25 billion CFA francs in mining dividends budgeted, only 4.6 billion CFA francs had been paid. The mining companies tend to wait until the exemptions that they are entitled to *in principle* have been applied before paying their dividends to the state shareholder.

The 2004 budget project provided for a 20 per cent increase in expenditure, of which 16 per cent was earmarked for current expenditure and 28.6 per cent for capital expenditure. The actual increase was probably closer to 7 per cent and represented nearly 9 per cent of GDP in 2004, compared to 8.2 per cent in 2003. On the basis of orders to pay, the execution of capital expenditure, at 67.3 in September 2004, was relatively satisfactory.

The difficulties encountered by the authorities in the revenue sector caused problems in the management of public funds. The government had to resort to issuing Treasury bonds worth 21 billion CFA francs ($39.7 million) in July 2004. This situation got worse subsequently. The government's financing needs were in principle 201 billion CFA francs ($379.8 million) (on the basis of payment orders excluding grants) and, with net internal financing negative, were to be financed up to 64 per cent by grants and 57 per cent by external loans. However, by the end of September, no more than 50 per cent of grants and 55 per cent of other expected external financing had been received, notably because of delays in the payment of budgetary aid by donors. These included the variable 2004 tranche of the European Union's ninth European Development Fund (EDF) and the adjournment of the $25 million structural adjustment loan IV from the World Bank, which was linked to disagreements over reform of the cotton sector. Solutions began to emerge at the end of 2004 with the realisation of budget support by a number of bilateral donors, payment of the EDF tranche, provision of emergency aid by the European Union via the Flex mechanism, as well as the issue of Treasury bonds which will be refinanced in the first quarter of 2005 by the release of structural adjustment loan IV by the World Bank. Nevertheless, to limit budgetary overspend, the IMF called for a 13 billion CFA franc ($24.6 million) reduction in expenditure, using, for example, the funds earmarked to finance the restructuring of public sector companies. The overall budget deficit in 2004 is estimated to have finished close to 3 per cent of GDP.

In counting on 5.7 per cent GDP growth, the 2005 budget implies a financing requirement excluding grants of 6.7 per cent of GDP. Taking into account grants expected to amount 3.4 per cent of GDP, this figure could come down to around 3.3 per cent. But major uncertainties surround implementation of the 2005 budget, starting with identification of financing sources. The CMDT's deficit, which will doubtless be covered by a state subsidy, could have an adverse effect on budgetary balances. The government has also stated that it does not intend to pass on the full burden of any future new increases in the price of oil to the price of petrol at the pump, and this despite the opposition of the IMF, which wants to see the state's financing requirement reduced. An agreement was nevertheless reached between the fund and the government on a minimum objective for revenues from domestic tax on oil products (TIPP) in 2005. In addition, no new subsidy will be granted to the electricity company, *Energie du Mali*, if there is a decrease in the price of oil.

These difficulties, which have come about because of the deterioration in the global economic environment, nonetheless underline the vulnerability of Malian public finances. This weakness comes largely from the narrowness of the fiscal base and so from the fragility of state revenues in a context of strong social demand for public spending on infrastructures and the fight against poverty. It should be pointed out that the authorities are determined to enlarge the fiscal base and build on progress already accomplished. The level of fiscal pressure rose from 13.4 per cent in 2002 to an estimated 15 per cent in 2004, which is a remarkable result at a period during which when import duties were stagnant. Reforms launched over the last five years such as the improvement of recovery capacity and its centralisation by the tax department (DGI), computerisation, the creation of a major companies section within the DGI, introduction of a fiscal identification number (NIF), and consolidated tax, all demonstrate the government's determination on this issue and have succeeded in increasing the level of fiscal pressure.

The major challenge facing the authorities remains taxation of the informal sector, including the agricultural sector, which today largely passes through the net. For budgetary year 2005, the DGI proposed taxing agriculture indirectly by cancelling exemptions granted to the *Banque nationale de développement agricole* (BNDA), and directly by applying VAT to those agricultural inputs and equipment which are currently exempted. These measures would produce additional fiscal revenues totalling 1.7 and 7.4 billion CFA francs respectively ($3.2 million and $14 million). The government's hesitations show how politically and socially sensitive the subject is, particularly as the authorities are probably still smarting from the controversy which has been growing since last year over the reform of the down payment on diverse taxes and duties (ADIT), the aim of which was to tax the informal sector through its imports[2]. This controversy, which reflects the imperfections of the existing system (which also hooks operators from the formal sector), illustrates the difficulty of taxing the informal sector, as well as the porosity between the formal and informal sectors in a country like Mali.

The Central Bank of West African States (BCEAO) fixes Mali's monetary policy which, taking account of the CFA franc's linkage with the euro, mostly follows that of the European Central Bank. In March 2004, the BCEAO lowered its discount rate from 5 to 4.5 per cent and its repurchase rate from 4.5 to 4 per cent –in real interest rate terms these reductions fall far short of counterbalancing price movements in Mali in 2004, which after falling an average 1.3 per cent in 2003, dropped a further 3.1 per cent. This trend is largely due to the movement of the euro and the good 2003/04 cereals harvest. There was, nevertheless, an increase in cereals prices at the end of 2004 following the poor 2004/05 harvest, as well as an increase in the petrol price

2. Before 2002, the ADIT was a deduction made at the customs barrier that was paid in addition to customs duties at a single rate of 5 per cent, reimbursable by the state in the form of a tax credit. The system was modified in 2002: regular economic operators belonging to the real taxation system pay a refundable rate of 3 per cent while others, including a large number of informal operators, occasional importers, economic operators without a fiscal identification number and/or without an imported goods pre-despatch verification certificate pay 15 per cent which is non refundable by the state.

in line with the international oil price. Between September and November of that year the cost of high-grade petrol rose 6.4 per cent. This could point the way to the scale of inflation to come in 2005, perhaps as much as 3 per cent. Price trends in 2005 will depend notably on the oil product taxation policy followed by the government. The existence of large cereal stocks, together with the strength of the euro, should nevertheless serve as ramparts against a major resurgence of inflation.

External position

The Malian economy is heavily influenced by external factors, notably the price of cotton, gold and oil; the dollar-euro exchange rates; rainfall and its effects on the cotton harvest; and the economic situation of neighbouring countries (notably, that of Côte d'Ivoire, which figured among Mali's major trading partners before the latest crisis). Since the prices of cotton and gold – Mali's two major export products – are quoted in dollars, the fall in the value of the American currency in 2004 could have harmed the country's trade balance. This potential damage was limited, however, by increases in the prices of the two commodities in question, particularly that of gold. It is important to note that the high price of gold owed a great deal to the weakness of the dollar. Cotton was sold at the very high international price pertaining at the start of 2004. The impact of the weakness of the dollar was also softened by the increase in the volume of exports such as fibre, cloth, thread and oil by the cotton sector. The BCEAO expects cotton sector exports to increase from 144.9 billion CFA francs ($273.7 million) in 2003 to 204.1 billion CFA francs ($385.6 million) in 2004.

Trade statistics showed a major deficit for the first nine months of 2004: exports totalled only 240.6 billion CFA francs ($454.6 million), compared with imports worth 505.3 billion CFA francs ($954.6 million), 106.4 billion CFA francs of which were hydrocarbons imports[3]. The reasons for the poor trade balance are the fall in gold exports and the increase in the value of oil imports. The fall in demand for Malian products from Côte d'Ivoire, which imported Malian products worth 2.4 billion CFA francs ($4.5 million) during the first nine months of 2004, compared to about 36 billion CFA francs ($68 million) per year from 1999 to 2001, also played an important role. Exports to Senegal, on the other hand, rose from 16.7 billion CFA francs ($30.2 million) in 2003 to 41.2 billion CFA francs ($77.8 million) from January to September 2004, according to BCEAO figures.

BCEAO figures also show that Mali registered a services deficit over the period 1999/2003 (the figure was at 7 per cent of GDP in 2003) - this is largely due to the country's land-locked position. The deficit in its transport services sector over the past few years has been several times higher than its trade deficit. In 2003, Mali's transport and insurance deficit totalled 170 billion CFA francs or $321.1 million compared to a trade deficit of 58 billion CFA francs or $109.5 million.

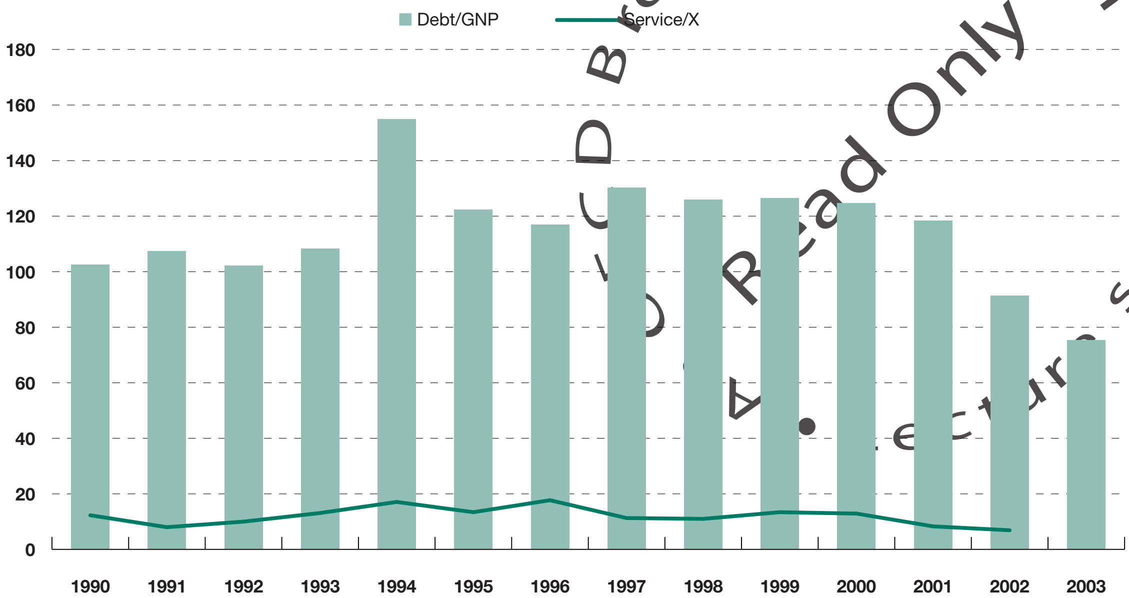
Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-4.3	-0.3	5.8	2.4	1.8	-0.6	-1.6
Exports of goods (f.o.b.)	15.5	24.1	27.5	22.9	24.0	22.0	20.5
Imports of goods (f.o.b.)	-19.8	-24.4	-21.7	-20.5	-22.2	-22.6	-22.1
Services	-10.5	-9.0	-6.0	-7.0			
Factor income	-1.5	-5.5	-7.4	-4.0			
Current transfers	6.9	4.5	4.5	4.4			
Current account balance	**-9.4**	**-10.3**	**-3.0**	**-4.2**			

Source: BCEAO and IMF data; estimates (e) and projections (p) based on authors' calculations.

3. These statistics come from the customs and do not necessarily match BCEAO projections for the full 2004 year.

Figure 6 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

Transfers from Malians living abroad fell sharply from 71 billion CFA francs ($134.1 million) in 2002 to 45 billion CFA francs ($85 million) in 2003. The troubles in Côte d'Ivoire and the resulting return to the country of 50 000 Malians is doubtless a major factor in this decline.

Mali's current balance shows a deep structural deficit, which represented 4.2 per cent of GDP in 2003. The external financing requirement that results from it is essentially financed by external aid. According to OECD Development Assistance Committee statistics, Mali received $528 million in development aid in 2003, which comes to about $45 per inhabitant. This figure is a lot higher than the figure for sub-Saharan Africa as a whole, which stands at $34 per inhabitant. About 85 per cent of this total was made up of grants.

Mali reached the completion point for the HIPC initiative in March 2003 and benefited from debt relief totaling $539 million in net updated 1998 value. At the end of 2004, outstanding external debt amounted to 1 863 billion CFA francs ($3.5 billion) or about 74 per cent of GDP. HIPC debt relief should reach 29.6 billion CFA francs in 2004 (17.8 billion CFA francs had been accorded in July) or $55.9 million. Although Mali is finding it difficult to reduce its debt-export ratio through an increase in exports, its post-HIPC position is fairly comfortable. It has a moderate debt service level – estimated at 6.2 per cent of exports of goods and services following the 2004 debt relief – and a favorable trend profile, since its debt-export ratio – estimated at 129 per cent in 2004 at current net value – should remain below 150 per cent over the next 15 years, according to the IMF's central projection. The scenario forecasts a progressive fall in gold production and persistent constraints on growth in the agricultural sector but, at the same time, dynamic performances by other economic sectors. Risk scenarios, based on rapid exhaustion of gold reserves, poor prospecting results and repeated droughts, underline the necessity of diversifying the economy and reinforcing the ability of debt stock to be concessioned. With this in mind, the government's objective is to progressively increase the grant element from 45 per cent in 2002 to 60 per cent.

Structural Issues

Structural factors - particularly those linked to its land-locked situation - severely limit Mali's economic development. The absence of a coastline makes improving access to ports in the region and reducing the cost of transporting imports and exports a priority. This importance of making these changes has become particularly acute as a result of the Ivorian crisis, which has disrupted access to the port of Abidjan (it takes half as long to reach Abidjan from Bamako as it does to reach Dakar). The country's land-locked situation and its high energy and telecommunications costs are all obstacles to the development of the private sector and, in particular, the formal sector. The absence of real industrial zones is also a problem. The government has become aware of these constraints on investment and taken measures to counter them. It has, for example, revised legislation governing taxation, the employment market and bankruptcy. Several government agencies like the *Centre National de Promotion des Investissements* and the *Direction Générale de la Géologie et des Mines* have set up specialised services for company creation.

There have also been a number of new initiatives in the transport sector. Mali's road network is of very much higher quality than it was 10 years ago even though it remains inadequate. The improvement is the result of work undertaken under the 1995-2004 sectoral transport project (PST), financed by several different donors. A PST-II should come into existence very soon. With regard to links with Senegal, the 712 km northern route via Kayes will be completely surfaced by December 2006. The Bamako-Didiéni and Sandaré-Kayes stretches have already been finished and the Kayes-Kidira stretch is scheduled for completion by November 2005. On the 490 km southern route via Kati, Kita and Saraya, which is a priority route in the NEPAD transport programme, the Kati-Kita stretch will be started in the second quarter of 2005. Work on the Naréna-Kourémalé stretch began in July 2004 and the route to Nouakchott will be completely surfaced by October 2006. Completion of the Bamako-Kourémalé road is scheduled for June 2005. Routes towards Côte d'Ivoire, Burkina Faso, Togo and Ghana are in the process of being improved. Work on another priority road mentioned in the NEPAD programme, the North East Gao-Ansongo-Labbezanga road to Niger, began in 2004. These projects will help to reduce the country's isolation and its dependence on the port of Abidjan. The government has adopted indicators for road maintenance so as to be able to follow implementation of the strategic framework for the fight against poverty (CSLP – see below). In 2003, 2 950 km of road had been surfaced, compared to an initial CSLP target of 3 024 km, and 1 475 km was in good or very good condition. The unsurfaced road network covers 5 550 km (as against the 2003 CSLP target of 5 976 km), only 687 km of which were in good or very good condition. In rail transport, the granting of a concession for the Dakar-Bamako railway in 2003 seems to have borne fruit, judging by the first good results achieved in 2004 by the concessionaire, Transrail SA, 51 per cent of the capital of which is held by the Franco-Canadian company, Canac-Getma. In 2004 freight transport tripled in relation to what it was before the granting of the concession, and a 35 billion CFA francs ($66.1 million) investment plan has been launched. The quality of passenger service has deteriorated, however, with a drastic reduction in the number of stations served, resulting in a highly unfavourable trend in terms of territorial development for a country as vast as Mali. Company investment, moreover, is heavily dependent on the support of international donors – the World Bank, the West African Development Bank, the French Development Agency (AFD) and the Canadian International Development Agency.

The low level of energy supply and its cost is another structural factor that is holding back Mali's development. The level of access to electricity is low – 13 per cent in 2003, slightly up from 2002's 12 per cent – and, at less than 1 per cent in rural areas, unevenly distributed. In Bamako, the level of electrification is 47 per cent. The number of subscribers rose from 118 806 in 2002 to 131 029 in 2003, while production capacity increased from 186 MW in 2002 to 223.6 MW in 2003. To increase supply, the national energy department is currently working on three hydroelectric power generation projects – a 34 MW plant at Kénié on the River Niger, a 59 MW plant at Félou, and another of 55 to 130 MW at Gouina on the Senegal River. The cost of electricity is currently at the centre of a dispute between the government and Saur International, a subsidiary of the French group, *Bouygues*, which is principal shareholder in *Energie du Mali*, the former state operator that was privatized in 2000.

Telecommunications infrastructures show a coverage level that remains low despite relatively strong progress in recent years. The level of coverage was at 4 per cent in 2004 (444 795) lines, which nevertheless represents a 44.3 per cent increase in relation on 2003 levels. A significant part of this increase is due to the portable telephone sub-sector, which opened 377 571 lines in 2004 compared to just 67 224 fixed telephone lines. In 2001, one year after the creation of Malitel, the portable telephone subsidiary of the public sector operator, Sotelma, there were just 23 997 portable telephone lines. In 2002, the state acquired the 44 per cent shareholding held in Malitel by Sogetel. A year later, Ikatel, a private sector competitor to Malitel owned by *France Télécom*, the Senegalese company Sonatel and former shareholders of Sogetel, all moved into the market. Virtually all of the recent growth in the market has been created by Ikatel, which operates 83 per cent of Mali's portable telephone lines and 70 per cent of all telephone lines in the country; the company uses 312 071 lines in all.

No major privatisation took place in 2004. The year was nevertheless marked by developments in the privatisation programmes of key companies such as *Société de télécommunications du Mali* (Sotelma) and the all-important CMDT. The terms of Sotelma's privatisation were set in December 2004: 51 per cent of the company's capital will be sold to a strategic investor, while 20 per cent will remain in the state's hands.

As for the CMDT, 2004 saw a lot of internal heart-searching, as well as difficult discussions with the World Bank. The reform and deregulation of the cotton sector is a priority for the Bretton-Woods institutions - particularly since the 2000/01 crisis - and a subject of discord between the Malian government and the World Bank. According to the latter, the CMDT is inefficient and lacks the resources to invest in the modernisation of its machinery, the result being that the prices paid to producers are too low. It should, therefore, be privatised, according to the World Bank. Taking account of the importance of the cotton sector in the local economy and its role in driving rural development, the subject is clearly extremely for the authorities. When the policy text on the development of the cotton sector (LPDSC) was updated in November 2003, the government opted for deregulation of the sector and the privatisation of the CMDT by the so-called "zoning" method rather than by vertical compartmentalisation of the different cotton activities and their piece by piece sale to the private sector. In this way, the CMDT's different collection zones would be hived off and privatised through sales to three or four private sector cotton companies, each of which would for a certain length of time have exclusive purchase rights for cottonseed in its zone. Strategic functions such as the supply of inputs and cotton grading would be managed at national level by an inter-professional organisation. The CMDT would concentrative its activity on ginning and marketing. Initially these changes were to be put into place in 2006, but a failed attempt at a partial sale to the American company Dunavant in 2003 persuaded the government to postpone the operation to 2008 (though the assets of the CMDT in the OHVN/Kita zone will, in principle, be sold-off before this date). The government is stressing the need to improve producer organisation prior to privatisation, and to better define the transfer of the public service missions currently carried out by the CMDT. It wants, therefore, to propose a new timetable for the operation, which has provoked discontentment on the part of the World Bank, particularly in a context of relations already strained by differences over the mechanism for fixing producer prices. After having decided to suspend structural adjustment loan IV, the bank has requested an assessment of the effects of postponement of privatisation on public finances, and an assurance that postponement would in no way be funded using money earmarked for poverty reduction programmes. Privatisation of the cotton oil processing company, Huicoma, has also been delayed. Negotiations with the bidder selected in November 2003 - the agricultural food processing company, Somdiaa, which had been due to take up 67 per cent of the company's capital - were broken off in March 2004. The state and Somdiaa were unable, notably, to reach agreement on the sanctions which would be applicable if the company failed to respect its investment obligations.

The Malian banking sector is relatively solid even though none of the banks respects risk diversification criteria. Given the structure of the Malian economy, the banking sector is over-exposed to the ups and downs of the cotton sector. 11 banks and financial institutions out of 12 at the end of 2003 respected the prudent ratio of 8 per cent of shareholders' equity, but the quality of the banks' portfolios has since deteriorated. Net and gross percentages of non-performing debt rose from 8.4 and 17.8 per cent respectively in December 2003 to 10.1 and 20.1 per cent in September 2004, which is relatively high. Moreover, the credit provided for the economy by the banking sector represents only 18 per cent of GDP. This low penetration of the Malian financial system clearly makes it difficult to finance risky activities such as those of SMEs.

Although the authorities are taking an increasing interest in the development and financing of SMEs, there does is no up-to-date inventory or even a single definition of what constitutes a small or medium-sized company, even in the formal sector. SMEs in Mali have the same problems as their counterparts elsewhere in the region: access to traditional bank financing is difficult, costly and principally short term. These difficulties can be attributed partly to the characteristics of the banking sector. Its extensive resources are essentially short term given the rather strict 75 per cent cover ratio imposed by the BCEAO for loans of more than two years (which have to be covered by resources with the same maturity, thus limiting financial intermediation). The deficiencies of the business environment, such as the inadequate level of training for business law magistrates, notably in relation to the standards set out by the African business law harmonisation organization (OHADA), and the potential difficulties in the use of bank guarantees, also plays a role. But the principal problem is the poor quality of the projects presented to the banks by entrepreneurs and/or the inadequacy of initial funding. In these conditions, the financing of SMEs does not represent a sufficiently attractive activity for the banks in terms of profitability adjusted for risk.

Numerous initiatives have been taken to overcome the problems facing SMEs, for example the commercial sector of the judicial system has received support, particularly in the form of magistrate training. The

The *Banque Malienne de Solidarité* (BMS), between Classical Bank and Micro-lending

The *Banque Malienne de Solidarité* (BMS), which has been in operation since mid-2002, is jointly owned by the state (which has a 20 per cent shareholding), and the savings and loan banks. It has relatively limited resources at its disposal and, overall, its shareholders do not impose very strict profitability criteria on it. This means that it is able to offer the financial leeway required by SMEs. The BMS demands little in the way of an initial down payment and has a system by which margin deposits are built up over time, starting from receipt of the first profits of the business. It offers reduced lending rates of around 7 per cent, compared with the usual level, which stands at around 16-18 per cent. Its ample reserves enable it to offer - albeit on a limited scale - medium-term financing and loans ranging from 10 to 50 million CFA francs (between $20 000 and $100 000). It is the absence of accessible loans on this scale in the mainstream banking system that penalises SMEs. The BMS also refinances micro-financing institutions. At the end of 2003, after 15 months of existence, it had collected deposits totalling 7 253 billion CFA francs ($13.7 million) and had granted loans totalling 9 188 billion CFA francs ($17.4 million) to 22 SMEs and 16 micro-financing institutions. These sums, which constituted less than 2 per cent of total bank lending to companies in Mali at the end of 2003, remain modest for the moment, but are encouraging for an institution which is still in its early days. At the same time, to satisfy demand in optimal conditions and on a bigger scale, the BMS needs additional stable, low-cost resources.

development of non-financial services to help companies prior to their submission of loan applications is also on the agenda. For example, approved management centres for retail distributors have been established, which are co-financed by the authorities and their development partners and which offer accounting assistance. Initiatives for the financing of SMEs are less numerous. The most significant one to date is probably the *Banque malienne de solidarité* (see box). The creation of institutions specialising in the financing of SMEs - using investment and/or guarantee funds - is currently under consideration. The European Union is considering relaunching its credit initiative mechanism, which was created within the framework of the seventh EDF to finance SMEs that had had their financing suspended because of poor management. Its conversion into a guarantee fund for the financing of SMEs is under consideration. As for micro-financing, this is a highly dynamic sector in Mali: there are 850 micro-financing establishments in the country which together make loans totaling 38 billion CFA francs ($71.8 million), or 6 per cent of all bank lending. Between the end of 2002 and the end of 2003, the sector's growth - measured by the total of micro-loans granted - was 54 per cent. Since 1998, the sector has been the object of a national micro-financing development strategy. For the time being the sector is still very fragile, but the professionalisation and consolidation which the government is seeking to introduce as a priority could enable it to "grow with its clients" and form the missing link between short term micro-lending and the medium and long-term bank lending which is inaccessible to SMEs.

Political and Social Context

Mali enjoys political and democratic stability, which inevitably boosts its economic environment. The current president, Amadou Toumani Touré, succeeded Alpha Oumar Konaré – who is currently president of the African Union – in democratic elections in May 2002; Konaré himself was also democratically elected. The political scene in Mali has a number of particularities. The President has no political party and there is virtually no organised political opposition. A new Prime Minister – Ousmane Issoufi Maïga – who, like President Touré, is not tied to any political party, was appointed in May 2004. The President's style of government is based on consensus, and the local elections in 2004 did not alter the political landscape in this respect. Although most commentators praise the stability achieved by this style of government, and underline the positive aspects of the Malian tradition of collective decision-making, some argue that unanimity is not very propitious to fundamental political debate on the major and difficult issues thrown up by the evolution of Malian society. For the moment, all the parties assure that they want to continue supporting the President, even though the alliance that was formed last year between the two principal parliamentary parties - the *Rassemblement pour le Mali* (RPM) and the *Alliance pour la Démocratie au Mali* (Adema) - was interpreted by the other political formations as representing the beginnings of a political alternative with a view to the 2007 legislative and presidential elections. In any case, it seems quite possible that the presidential and legislative elections – scheduled respectively for April and July 2007 – will bring an end to the existing political consensus.

The process of decentralisation has hardly started in Mali, but it is a priority for the donors. The European Union's 2003/07 Indicative Programme is heavily orientated towards the reinforcement of public sector capacity – largely through decentralisation, to which €70 million has been devoted. USAID is sponsoring a programme of shared governance (PGP), designed to strengthen local capacities, notably those of non-governmental organisations.

In 2002 Mali occupied 174th place (out of the 177) in the United Nations Development Programme's (UNDP) human development index classification (HDI) – only Burkina Faso, Niger and Sierra Leone were lower ranking. As the HDI is a weighted average of GDP per inhabitant and social indicators as life expectancy, the level of children in full-time education and the illiteracy rate, this low ranking indicates that poverty in Mali is not just a question of low revenue per capita: it is a multi-dimensional phenomenon. On the basis of GDP per capita, Mali is classed 163rd, which brings to light the fact that in social, health and educational terms Mali is much worse off than other countries with the same level of income per inhabitant.

The impact of economic growth on poverty in Mali remains limited. The growth of revenue per inhabitant in Mali in the 1990s was quite strong in comparison with neighbouring countries, yet poverty did not diminish during this period. The major policies for dealing with poverty are set out in the strategic framework for the fight against poverty (CSLP), which was adopted by the government in May 2002 and approved by the IMF and the World Bank at the start of 2003. The CSLP serves as a reference point in all discussion on economic and social policy in Mali today. It defines three main areas for action: institutional development and the improvement of governance and participation through, among other things, decentralisation and the devolution of public services; sustainable human development and the widening of access to basic social services; and the development of basic infrastructures such as roads, airports, railways and telecommunications.

The CSLP's first annual report was published in April 2004, this brought to a close the second phase of a process, the initial stage of which had been the drafting of the initial document and its approval by the multilateral partners. This second phase involved producing a pared down and operational list of indicators that will enable the progress of the implementation of the CSLP to be monitored. The Malian government finally adopted about 40 indicators, covering growth, public finances, education, health and infrastructures, though its partners would have preferred a shorter list. At a round table meeting on the CSLP in Geneva in March 2004, which was attended by both the authorities and donors, the latter broadly approved implementation of the CSLP and promised aid totalling about \$2.4 billion during the 2004/06 period. Both the development partners and the government acknowledged the existence of deficiencies in the document - starting with the very high economic growth target of 6.7 per cent per year for the 2002/06 period. This ambitious target was set because – as mentioned above – poverty levels in Mali do not react to slight increases in economic growth but, given Mali's recent growth record, it is unfortunately not very realistic. The development partners insist that a thorough analysis of the factors determining growth and the links between growth and poverty is indispensable. The Malian government has proposed setting up a single reception point to facilitate the absorption of aid and pleaded for a more rapid redirection aid towards direct budget support.

To support the implementation and evaluation of the CSLP, the government has at its disposal data produced by a new survey of households, the Malian survey for the evaluation of poverty (EMEP), which was carried out in 2001/02, and a less elaborate survey which brought this data up to date in 2003. This data, which has not yet been fully analysed, makes it possible to define the objectives of public policies for the fight against poverty and also to describe the state of poverty and its different dimensions in Mali.[4]

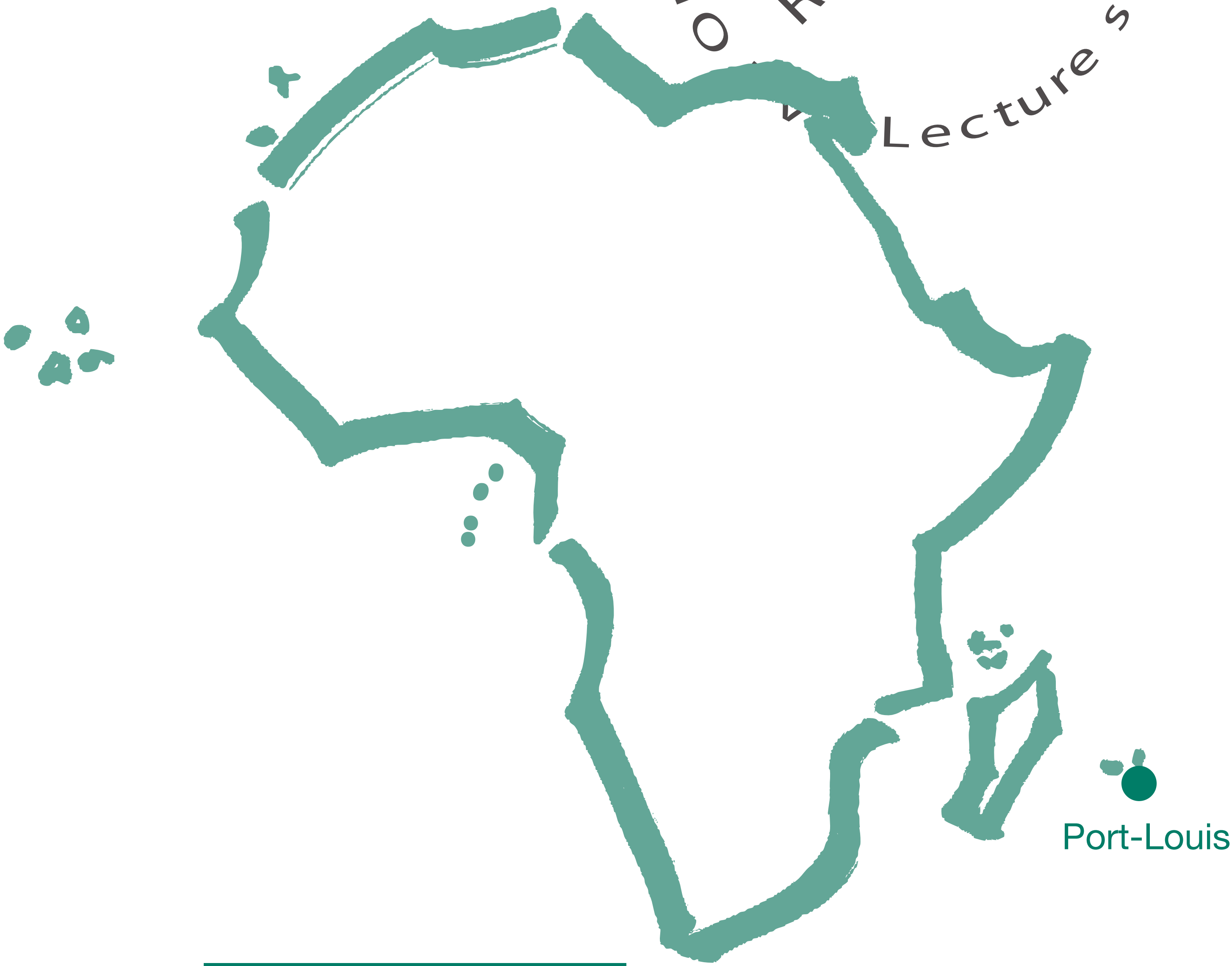
The literacy rate in 2002 was 35 per cent, well below the 45 per cent target set in the CSLP. According to an EDF-funded report on the system of evaluation of the CSLP, the literacy-indicator on which official statistics are based is in fact an indicator not of literacy levels as such but rather of pass rates in assessments carried out by centres of education, and so probably overestimates actual literacy levels (Unesco suggests a rate of only 28.7 per cent in 2004). The gross rate of children in full-time education at primary level in 2002/03 was 67 per cent for all children of school age, and 56 per cent for girls. School attendance rates for both primary and secondary education was 26 per cent, according to the UNDP. In 2002/03 the number of pupils per teacher at primary level was 61.1:1, a figure that beats the ratio aimed for in the initial CSLP of 70 pupils per teacher.

Infant mortality in 2004 was 114.7 per 1 000 births, according to United Nations figures. In 2003, 46 per cent of the population lived within five kilometres of a functioning healthcare centre. However, donors queried the ambiguity of the notion of "functioning".

4. Most indicators are not updated beyond 2002. These provisional statistics should be treated with caution.

The definition of this word in the CSLP is based on a method of weighting of different criteria such as the quality of the establishment; its relations with the community; the quantity and quality of its personnel; and the diversity of its medical activities. But the analysis carried out under the auspices of the EDF stresses that the people questioned tended to equate functionality with proximity. In 2003, 79 per cent of children less than one year old had been given the DTCP 3 vaccine (which protects against diphtheria, tetanus and whooping cough). The level of infection by HIV/AIDS is relatively low in relation to the situation elsewhere in Africa: 2.5 per cent of the population between the ages of 15 and 49 was contaminated at the end of 2003. The death rate from malaria and tuberculosis, which stood at 58.3 and 26.8 per 1 000 respectively in 2001, are more worrying because they have been on the increase over the past decade.

Mauritius



key figures

• Land area, thousands of km^2	2
• Population, thousands (2004)	1 233
• GDP per capita, $ (2003)	4 628
• Life expectancy (2000-2005)	72
• Illiteracy rate (2004)	14

SINCE 1975, MAURITIUS HAS ACHIEVED steady economic growth of more than 5 per cent, reaching one of the highest gross national incomes (GNI) per capita in Africa. In a generation, the country has undergone a deep transformation from mono-crop (sugar) production into a diversified economy built on five pillars, namely, sugar, export processing zones (EPZ), tourism, financial services and information and communications technology. Remarkably, Mauritius' development has been financed almost entirely by domestic savings, which have been intermediated efficiently through a sound domestic banking system, while foreign direct investment has played a minor role. This impressive economic record owes much to the stable and democratic political regime, the high quality of strong institutions based on the rule of law, intensive investment in human resources, sound macroeconomic policies and a remarkable capacity to respond to challenges.

The impending loss of trade preferences in sugar and textiles challenges social and economic achievements.

However, the country's capacity to adjust to changing conditions is going to be forcefully tested

Figure 1 - Real GDP Growth

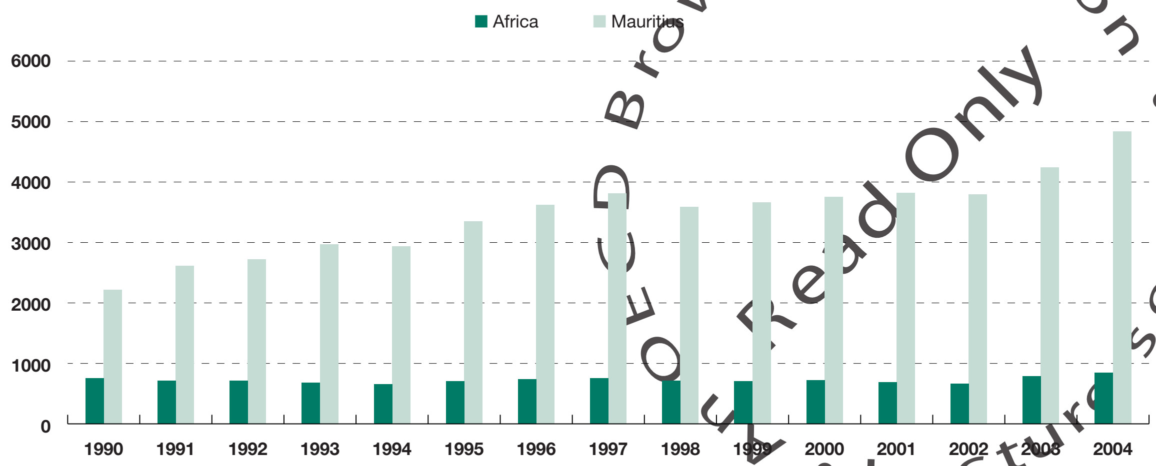
Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

again in the coming years, as it is faced with three major challenges. First, the expected changes in preferential trade arrangements for sugar and textiles, at a time when these key sectors are confronted with higher unit labour costs. Second, persistent fiscal imbalances which, combined with a narrow tax base and high government debt, may jeopardise macroeconomic stability. Third, rapidly increasing unemployment, primarily among low-skilled workers, may worsen in coming years, unless significant labour market reforms take place. In addition to these challenges, as an oil importing country, Mauritius has had to deal in recent years with the impact of higher world oil prices on its economy.

Recent Economic Developments

In 2002, the island was devastated by cyclone Dina which, together with low sugar prices, slowed economic growth to 1.9 per cent. It rebounded to 4.3 per cent in 2003, reflecting the recovery of tourism and sugar production and strong construction, transport and financial

Figure 2 - **GDP Per Capita in Mauritius and in Africa** (current $)



Source: IMF.

services activity. However, the EPZ sector continued to record negative growth, due to high domestic production costs and increased foreign competition. This recovery is expected to be sustained in 2004 and 2005 with real GDP growth at about 4 per cent.

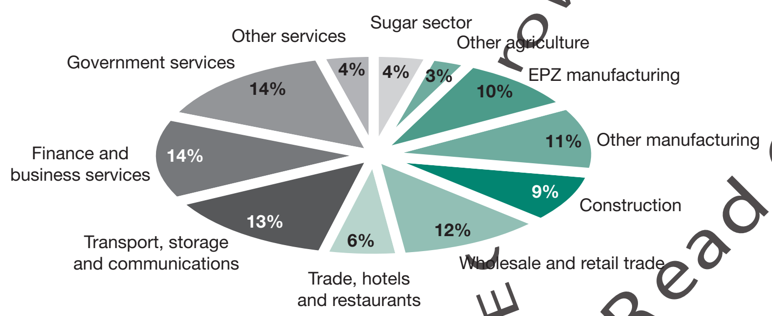
Agriculture is largely dominated by the sugar sector, which has long been the backbone of the economy. More than 80 per cent of arable land is used for sugar cane cultivation, which remains vulnerable to the vagaries of the weather (agricultural output was adversely affected by drought in 1999 and extensively damaged by the cyclone in 2002). In 2004, sugar output accounted for 5 per cent of GDP, used about 9 per cent of the labour force and contributed to about 13 per cent of exports.

The sugar sector is governed by two agreements (the EU Sugar Protocol and the Lomé Convention and subsequently the Cotonou Agreement) with the European Union guaranteeing tariff-free quotas and high prices. Under the Cotonou Agreement, the protocol will continue until December 2007. However, the price Mauritius obtains for its sugar is expected to decline substantially, as a result of the Everything But Arms (EBA) initiative granting duty-free and quota-free access to exports from 49 least-developed countries. It is estimated that the impact of the price decline could adversely affect exports by 2 to 4 per cent and GDP by 0.2 to 0.5 percentage point in 2005-07.

To address such a shock, the authorities have implemented a sugar strategic plan since 2001, aiming at reducing production costs and centralising sugar factories in order to achieve economies of scale. As a result of this plan, costs declined from $0.20/lb in 2000 to $0.14/lb in 2003 (with significant job losses) but they remain significantly higher than the world market price (around $0.08/lb). Mauritius is also trying to negotiate with the EU a slowdown in the implementation of the European Commission decision to reduce by 37 per cent guaranteed prices for sugar over four years. At the same time, the authorities are promoting the diversification of the agricultural sector through the implementation of a strategic plan for the non-sugar sector covering the period 2003-2007, which focuses on the development of other cash crops, such as tea and horticultural products as well as food crops to attain a degree of self-sufficiency.

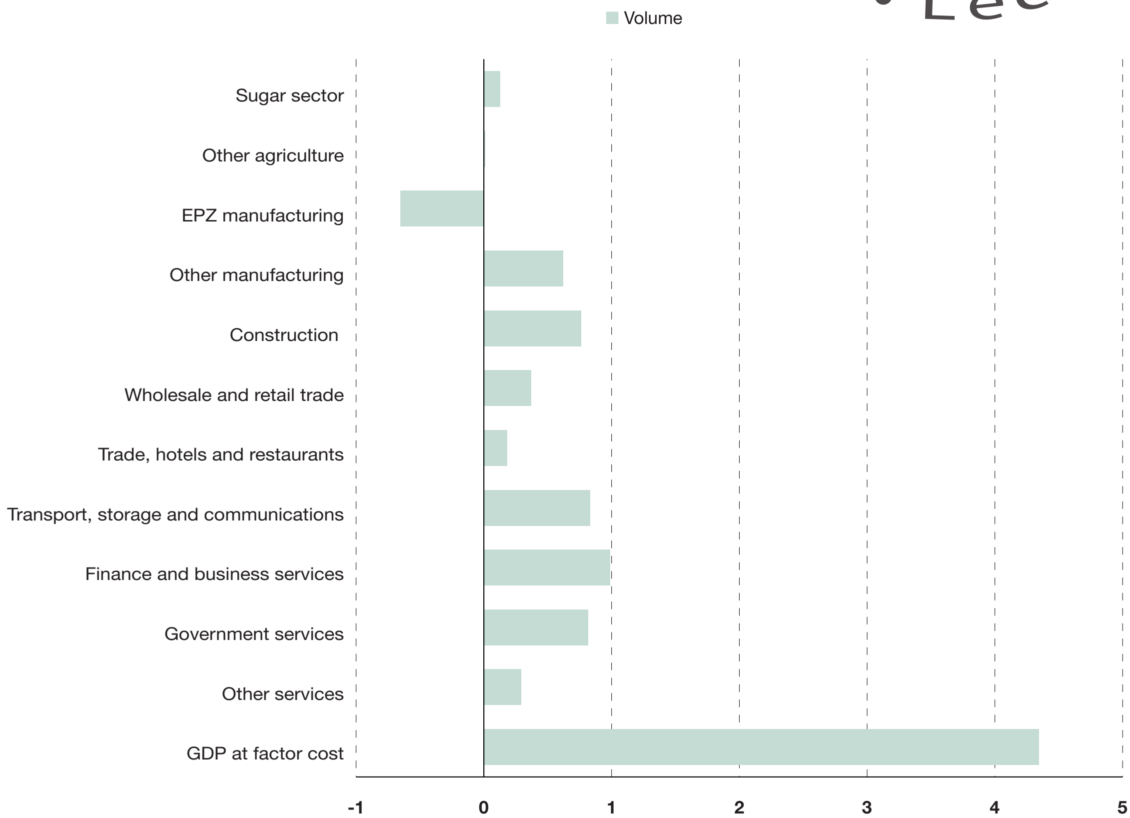
The manufacturing sector has been the main vector of diversification out of sugar. Manufacturing contributed 19 per cent to GDP in 2003 with EPZ accounting for nearly half of it. In 2003, EPZ exports amounted to almost 60 per cent of total exports and the sector employed about 17 per cent of the workforce, mostly in the textile industry. The main export markets are the EU and the United States. In both markets, Mauritius is vulnerable to foreign competition, a challenge compounded by the expiration of the Agreement on Textiles and Clothing (ATC) at end-2004. In addition, Mauritius cannot qualify

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on Central Statistics Office data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on Central Statistics Office data.

for the third-country provision under the Africa Growth and Opportunity Act (AGOA) in the US market because of its relatively high per capita income. As a result, a number of textile enterprises have invested in least-developed countries, e.g. Madagascar, Mozambique and Senegal, which benefit from the AGOA for their exports to the United States. Nevertheless, the textile industry has won a significant victory with the inclusion of Mauritius in the list of member countries of AGOA which have access to Third-Country Fiber (TCF) privileges allowing members to source fabrics from anywhere and still qualify for AGOA exemptions. The TCF privileges have been extended for one more year and can be renewed again through 2007. Furthermore, since 2002 the authorities have started implementing a strategic plan in favour of the textile and clothing sector to foster corporate restructuring, technology upgrading and product and market diversification. In October 2004, the government announced the creation of Enterprise Mauritius, combining the activities of the Mauritius Industrial Development Authority and the Export Processing Zone Development Authority. These measures have contributed to the rise in unemployment from 9.7 per cent in 2002 to 10.6 per cent at end-June 2004.

Tourism, the third pillar of the economy, remains a mainstay of the country's growth. It has hardly been affected by the worldwide slump of 2001 and the impact of high oil prices on the airline industry in 2003-2004, reportedly because Mauritius has opted for the middle to high-income segment of the tourism market, which is less subject to shifts in global demand. The sector contributed 5 per cent to GDP in 2003; it employs about 7 per cent of the labour force, not including indirect employment in transportation, insurance, and banking and is a major source of foreign exchange earnings. Tourist arrivals (mainly from Europe) rose by 21 per cent and nights spent increased by 23 per cent between 1999 and 2003.The sector is expected to further strengthen in the future. Additional capacity of about 40 per cent is being built; 25 new hotels are under construction, of which 17 are expected to be available by 2006.

The sound and fast-growing financial sector contributed about 9 per cent to GDP in 2003. It consists of 10 commercial banks, 13 offshore banks, 23 insurance companies, 10 investment companies and 6 mutual funds. The stock exchange total market capitalisation amounts to about $1.5 billion. Mauritius has implemented legislation, including the Financial Services Development Act and the Anti-Money Laundering Act to bolster the soundness and effectiveness of the financial system. The main aim of this legislation is to promote the country as a major regional financial centre.

The information and communication technology (ICT) sector is also very dynamic, contributing to diversification into a fast growing and high productivity activity. ICT services are provided by 22 call centre companies, 15 business process outsourcing companies and 10 software companies. A new technology park at Ebene is under construction, including the Cyber Tower built in April 2004. In parallel, the authorities are putting a strong emphasis on training to meet the sector's skill requirements. Legislation on data security, intellectual property rights and human resources development has been enacted to enable the country to have a vibrant and growth-generating ICT sector. The authorities are also launching an e-government programme linking official service providers and enabling citizens to benefit from government services using the web.

The strong growth performance has been driven by the high rate of domestic savings. Savings have exceeded domestic investment by a significant margin since 2000. In 2003 the savings rate is estimated at 24.9 per cent of GDP and the investment rate at 23.6 per

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**24.4**	**20.7**	**22.1**	**23.6**	**25.0**	**26.8**	**27.7**
Public	9.4	7.1	6.9	8.8	7.6	7.4	7.4
Private	15.0	13.7	15.2	14.8	17.3	19.4	20.3
Consumption	**76.3**	**73.3**	**74.9**	**75.1**	**77.2**	**76.9**	**76.5**
Public	13.4	12.7	12.8	12.9	13.1	13.3	13.1
Private	62.9	60.7	62.1	62.2	64.2	63.6	63.3
External sector	**-0.7**	**5.9**	**3.0**	**1.3**	**-2.2**	**-3.6**	**-4.2**
Exports	63.8	68.4	62.0	56.3	54.6	54.5	53.4
Imports	-64.5	-62.5	-59.0	-55.0	-56.8	-58.2	-57.6

Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

cent of GDP. Remarkably, foreign direct investment has played a minor role. High savings have helped to finance domestic diversification, as well as productive investment abroad in recent years.

Inflation has remained subdued in recent years. It rose to 5 per cent in 2001 and 6 per cent in 2002 owing to the impact of severe weather conditions on food prices, an increase in value added tax rates, and higher electricity prices. However, it fell to 3.9 per cent in 2003 and is estimated at 4.7 per cent in 2004; it is expected to rise to 5 per cent in 2005 mainly because of the impact of high oil prices.

In recent years, the authorities have made an effort to adjust the prices of utilities and petroleum products to stem the losses of public utility and trading companies. They introduced an automatic price adjustment mechanism for petroleum products in early 2004, reflecting changes in international oil prices. Under this mechanism, domestic prices for petroleum products are adjusted on a quarterly basis. This has stemmed some of the losses incurred by the State Trading Corporation (STC). Such losses represented 62.5 per cent of the sales price for premium gasoline, 55.8 per cent for diesel and 41 per cent for kerosene in 1999/00. In 2004/05 in spite of the adjustment mechanism, STC was still making losses on kerosene

Macroeconomic Policies

Fiscal and Monetary Policy

Persistent large budget deficits are jeopardizing medium-term sustainability. With total revenue and grants falling short of covering even current expenditures, the expansion of capital expenditures to keep the economy competitive has resulted in recent years in fast growing fiscal deficits.

The fiscal deficit grew from 3.8 per cent of GDP in 1999/00 (July-June) to 6.2 per cent in 2002/03. Fiscal performance, however, improved somewhat in

Table 2 - **Public Finances**[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total Revenue and grants[b]	**17.4**	**18.3**	**18.4**	**20.2**	**20.3**	**19.9**	**19.9**
Tax revenue	15.6	16.2	15.7	17.3	17.5	17.7	17.7
Grants	0.3	0.2	0.2	0.2	0.4	0.3	0.3
Total expenditure and net lending[b]	**24.3**	**24.9**	**24.5**	**26.4**	**25.6**	**25.0**	**24.7**
Current expenditure	20.0	21.2	20.3	21.0	21.0	20.6	20.4
Excluding Interest	*16.9*	*17.1*	*17.0*	*16.8*	*17.1*	*16.9*	*16.7*
Wages and salaries	7.2	6.6	6.5	6.2	6.6	6.5	6.5
Interest	3.2	4.1	3.3	4.3	4.0	3.8	3.6
Capital expenditure	3.6	3.6	3.7	4.7	4.3	4.1	4.0
Primary balance	**-3.7**	**-2.6**	**-2.7**	**-1.9**	**-1.4**	**-1.3**	**-1.1**
Overall balance	**-6.9**	**-6.6**	**-6.1**	**-6.2**	**-5.3**	**-5.1**	**-4.8**

a: Fiscal year begins 1 July.
b: Only major items reported.
Source: Central Statistical Office data; projections (p) based on authors' calculations.

2003/04, with the budget deficit reduced to 5.3 per cent of GDP, reflecting higher tax and grants, while expenditure declined from 26.4 per cent of GDP in 2002/03 to 25.6 per cent of GDP. The budget for 2004/05 aims at containing the deficit at 4.7 per cent of GDP, through the introduction of a tax package that would yield about 1 per cent of GDP. However, the deficit is estimated to reach 5.1 per cent partly because of revenue shortfalls and increased spending in education and other social sectors; it is likely to remain high at about the same level in 2005/06.

As a ratio of GDP, tax revenue has been hovering around 17.5 per cent during the past two fiscal years and is expected to remain unchanged in 2004/05 and 2005/06. A major challenge is the broadening of the narrow tax base, with the informal sector escaping the tax net and the formal sector benefiting from generous tax exemptions. The setting up of an independent Revenue Authority is likely to help revenue performance. In 2004/05, there was an increase in some excises and a broad income tax reform, including a redistribution of the tax burden from low to high-income earners and an increase in the contribution of the corporate sector. However, there are no significant measures to reduce existing exemptions, notably regarding VAT.

As regards expenditure, current outlays exceed 20 per cent of GDP, owing in part to high current transfers and subsidies, including the generalised subsidies on rice and flour and subsidies to public enterprises to keep the prices of public utilities low. These transfers and subsidies have remained high at more than 8 per cent of GDP. The financial support provided by the government to state companies also takes the form of lending and loan guarantees. Interest payments have risen from 3.4 per cent of GDP in 1999/00 to 4 per cent of GDP in 2003/04. Capital expenditures have increased from 3.8 per cent of GDP in 1999/00 to about 4.3 per cent per cent in 2003/04.

The growing fiscal deficits have resulted in a high public debt/GDP ratio exceeding 70 per cent in 2003/04 (mostly in the form of short-term domestic debt) – a problem compounded by the difficult financial situation of some public enterprises and the future needs of pension funding in view of the ageing of the population. In the absence of significant fiscal adjustment, public debt could become unsustainable.

Beyond the new tax measures already taken, the authorities intend to improve expenditure prioritisation by implementing a medium-term programming and budgeting framework. In line with the New Economic Agenda (NEA), a five-year reform programme introduced in 2001/02, the government is committed to reducing the fiscal deficit to 3 per cent of GDP by 2005/06 and intends to improve the domestic debt maturity profile through the issuance of a wider range of longer-term instruments.

The monetary authorities have succeeded in maintaining low and stable inflation. They have pursued a prudent monetary policy with close attention to reserve money. The Bank of Mauritius (BOM) has used the Lombard rate (as the lender of last resort, BOM provides a Lombard facility for banks to borrow overnight to meet reserve requirements) to signal its monetary stance. On 21 October 2004, BOM increased the Lombard rate by 25 basis points to 9.75 per cent, in response to inflationary pressures from increasing oil prices. The banking system has been experiencing excess liquidity, reflecting weak credit demand (with slack in the activity of key economic sectors) and a cautious stance of banks toward credit; BOM intends to mop-up this excess liquidity to prevent it from becoming a potential source of rapid money growth. In parallel, government borrowing from the banking system has increased significantly.

The financial sector is globally sound and efficient. The Mauritius Commercial Bank and the State Bank of Mauritius, the two largest domestic banks, hold about 70 per cent of total assets of the domestic banking system. Sugar, tourism and textiles companies account for about 40 per cent of bank credit. Manufacturing, including the EPZ, has the second largest share of distressed loans. However, the high levels of bank capital and profits, extensive collateralisation and provisions reduce bank vulnerability. Banks have already reduced their exposure to sectors with the highest risk, e.g. the EPZ. The offshore banking sector has recorded fast growth in recent years but is still weakly integrated to the domestic economy.

Non-banking financial institutions are well developed in Mauritius. In addition to 22 insurance companies, 1 095 pension funds, 262 credit finance companies and 12 leasing companies were recorded at the end of 2002. Regulation and supervision of the non-bank financial institutions, particularly deposit-taking institutions, however, need to be strengthened. The market for government debt instruments could be supplemented by the development of a corporate bond market. Such a market would provide an outlet for non-bank financial institutions to invest in long term assets.

External Position

In Mauritius' managed float regime, the exchange rate has been mainly market determined, as BOM has limited its intervention in the exchange market to smoothing volatility. The real effective exchange rate has been stable in recent years. Mauritius is an open economy with no significant non-tariff barriers (except state trading). The unweighted average nominal tariff rate is 18.5 per cent. In 2003, total trade amounted to 73 per cent of GDP.

Mauritius is a member of the Southern African Development Community (SADC) and of the Common Market for Eastern and Southern Africa (COMESA), both planning a customs union. Since August 2004, Mauritius chairs SADC.

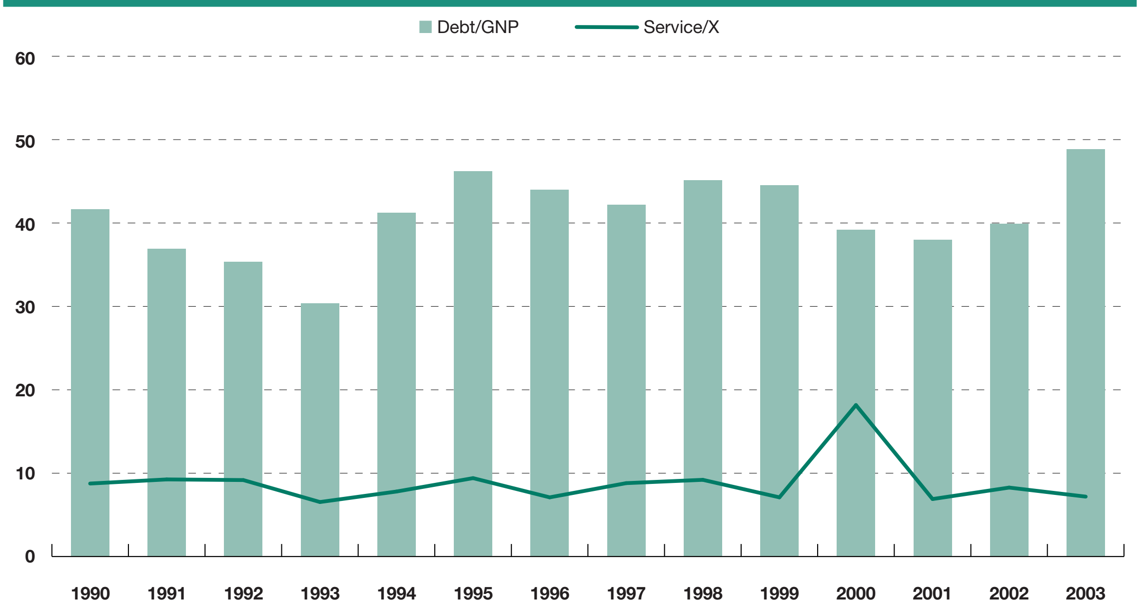
The external current account has posted a sizeable surplus in recent years, as the net surplus for tourism (7.6 per cent of GDP in 2003) has more than offset the trade deficit and net current transfers have been positive. However, it is expected to weaken over the medium term as a result of the anticipated decline in textile exports and a possible slowdown in sugar exports. Exports are still relying heavily on sugar and textiles. The main markets are the EU, particularly France and the United Kingdom and the United States. Imports consist mainly of foodstuffs, manufactured goods, machinery and transport

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-7.4	-3.2	-4.4	-5.3	-9.0	-11.4	-12.5
Exports of goods (f.o.b.)	41.8	41.5	37.9	33.6	31.8	30.6	28.9
Imports of goods (f.o.b.)	-49.2	-44.7	-42.3	-38.9	-40.8	-42.0	-41.5
Services	5.9	6.8	8.5	7.6			
Factor income	-0.9	0.2	0.3	-0.6			
Current transfers	2.4	1.1	2.2	1.1			
Current account balance	**0.0**	**4.9**	**6.6**	**2.8**			

Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

equipment and oil products. The latter accounted for 12 per cent of total imports in 2003. The index of import unit value has risen by 25 per cent between 1999 and 2003, which contributed to a worsening in the terms of the trade index from 101 in 1999 to 94 in 2003.

The overall external surplus has helped to increase external reserves to the equivalent of 9 months of imports. External debt declined from 23.5 per cent of GDP at end-2000 to 17 per cent of GDP at end-2003. The debt service ratio to exports of goods and services is extremely moderate; it declined from 9.8 per cent at end-June 2000 to 8.2 per cent at end-June 2003.

Structural Issues

In spite of a sustained economic growth, unemployment rose steadily from less than 3 per cent of the labour force in 1990 to 10.6 per cent of the labour force in June 2004. Unemployment is primarily experienced by low-skilled workers. Efforts to reduce unit labour costs in the sugar and textile sectors have been associated with significant layoffs, mainly among low-skilled workers. Male unemployment rose more slowly (from 8.5 per cent in 2002 to 9 per cent in 2003) than female unemployment (from 12 per cent to 12.6 per cent). Unemployed workers face long spells of joblessness with an average of 20 months. In addition to loss of preferential access to traditional markets, the rise in the unemployment rate is due to labour market rigidities and skill mismatch. Being highly regulated, the labour market is characterised by restrictions on workers' redeployment, wage setting and terminations. Wage setting is carried out through an annual tripartite process involving representatives of workers, industry executives and government and indexing economy-wide wage growth to inflation. Terminations are subject to time consuming procedures and have to be approved by a national termination board. More flexibility would have allowed bargaining at the firm level, taking into account the particular conditions of the firm.

As to the skill mismatch, the authorities are focusing on education reform and specialised training in job seeking sectors such as ICT and tourism. With an adult literacy rate of 90 per cent, Mauritius ranks among the most advanced emerging countries. Primary and secondary education is free, and attendance at primary school level is universal. However, the drop out rate of 35 per cent at the secondary education level is high and the government is taking measures to decentralise secondary education and facilitate pupil access. At the university level, the government is planning to increase the number of polytechnics. A White Paper on the reform of tertiary education has been prepared and, with the creation of a council on human resource development, the focus is on fostering training to match the skill requirements of the economy. The central objective of the reform of the education system and job training is to transform Mauritius into a high-tech knowledge-based country.

With a vibrant private sector contributing to a high savings rate, the government would have been expected to undertake a vigorous drive to privatise part of the large public sector, to reduce its burden on the budget and improve the efficiency and service delivery of public enterprises. The parastatal sector is extensive with 34 non-financial public enterprises, employing 16 000 workers in various economic sectors. It also includes eight financial institutions such as the Development Bank of Mauritius, the Housing Bank and the State Insurance Corporation.

The overall quality of life has very significantly improved in the last 30 years. Poverty has been reduced to localised pockets. Income distribution, as measured by the Gini coefficient, improved from 0.387 in 1996/97 to 0.371 in 2000/01. Life expectancy was 72 years in 2002 compared with 63 years in 1970. The UNDP Human Development Report ranked Mauritius in its middle range. Mauritius is also likely to achieve the Millennium Development Goals by 2015.

Appropriate allowance needs to be made for the ageing population and pension funding. Demographic developments indicate transitions from high fertility and mortality rates to lower ones. Demographic projections show a rise in the proportion of the elderly (over 60) from 9 per cent of the population in 1999 to 24 per cent of the population in 2041 and a substantial

Initiatives to Promote SMEs in Mauritius

Since independence, Mauritius has pursued a consistent policy to encourage the creation and promotion of small and medium enterprises (SMEs). It started by setting up a Small Industries Development Organization (SIDO) as a department of the Ministry of Industry to help small enterprises engaging in manufacturing. In 1993, an Act established the Small and Medium Industries Organization (SMIDO) as a public body fostering the growth and development of SMEs in Mauritius. Its mission is to consolidate, expand and enhance the competitiveness of SMEs. Its vision is a strong and modern SME sector that is efficient, competitive and export-oriented. CSO has defined small enterprises as those with fever than 9 workers and medium enterprises as those with 10 to 50 workers. SMIDO defines SMEs as those engaged in manufacturing with an investment in production equipment not exceeding 10 million rupees. To qualify for benefits, enterprises which meet that criterion need to register with SMIDO. Presently only 2 300 enterprises are registered out of 12 000 manufacturing enterprises and a total of 77 000 enterprises in the country. The conditionality for registration is quite demanding and time-consuming. However, once registered, SMEs enjoy extensive tax and other advantages.

Tax incentives are as follows: reduced corporate tax of 15 per cent compared to the standard rate of 30 per cent and duty free imports of raw materials and equipment. Financial advantages include guarantee of 50 per cent of loans extended to SMEs that are unable to provide collateral and seed capital provided by an Equity Participation Fund up to 300 000 rupees.

A venture-capital scheme is also available to finance direct investment in the equity of enterprises engaged in high value-added activities in manufacturing and ICT up to 250 000 rupees with the possibility for shareholders to buy back, after six years, the investment at a negotiated price. In addition, SMIDO provides market intelligence data and training in accounting, project management and export promotion.

An SME village has been set up in Terre Rouge, close to the capital, Port Louis, to provide low cost industrial space with all infrastructural facilities such as electricity, water and sewerage. The Development Bank of Mauritius plays a major role in financially assisting SMEs, but other financial institutions such as the Mauritius Post and the Cooperative Bank are also active. In December 2003, the government created a new Ministry of SMEs to cater for the promotion of the sector. This Ministry is currently preparing a new Act to better organise the sector and address its challenges.

reduction in the pension support ratio from 7.5 to 1 in 1999 to 2.4 to 1 in 2041.

Political Developments

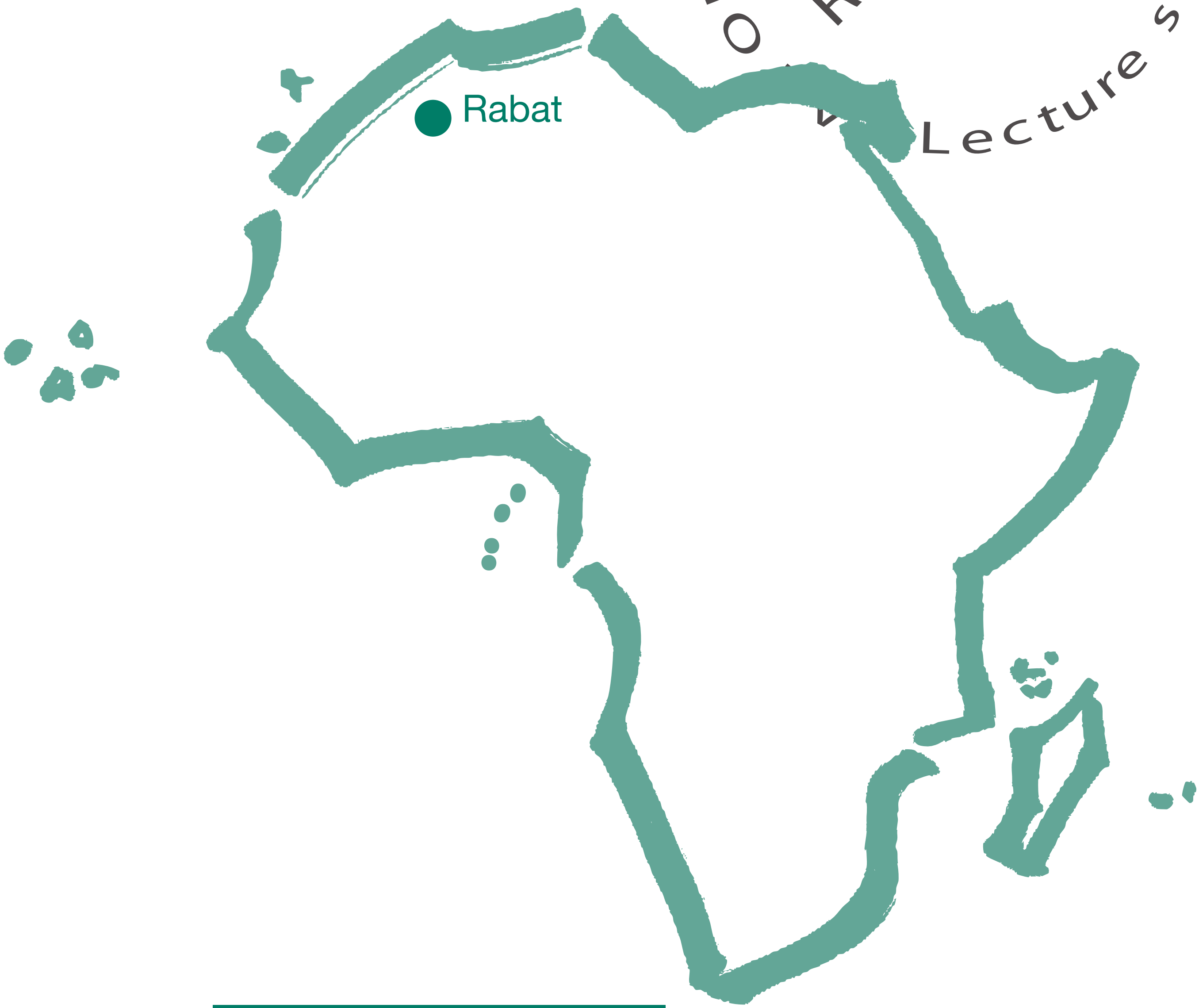
In addition to its free press, Mauritius' independent judiciary and the firmly established rule of law are the most significant features of its vibrant democracy. Mauritius is a multiparty democratic republic and has enjoyed a stable political regime based on the Westminster model since independence on 12 March 1968. The country has three main ethnic groups: Asian, European and African.

The legislature has 70 members elected by universal suffrage every five years in 20 three-member constituencies on Mauritius and one two-member constituency on Rodrigues, plus eight "best losers". The last general election was held on 11 September 2000. The next elections are scheduled between August and October 2005. A coalition of the Mauritian Militant

Movement (MMM) and the Militant Socialist Movement (MSM) won the elections of 11 September 2000. On the basis of a pre-election agreement to share the post of Prime Minister, Former Deputy Prime Minister and Minister of Finance, Paul Bérenger, leader of the MMM and member of the non-Hindu minority, has taken over the premiership from MSM leader Sir Anerood Jugnauth, who became President in October 2003 in a smooth transition.

Governance has been good with satisfactory ratings from international ranking agencies. In 2003 the World Economic Forum ranked Mauritius as the fifth country in Africa with regard to the quality of its public institutions. Mauritius has ratified UN human rights conventions. Among African countries included in the New Partnership for Africa's Development (NEPAD), Mauritius has been selected as one of the pilot countries for the peer review exercise.

Morocco



key figures

• Land area, thousands of km²	447
• Population, thousands (2004)	31 064
• GDP per capita, $ (2003)	1 431
• Life expectancy (1995-2000)	68.7
• Illiteracy rate (2004)	47.5

THE MOROCCAN ECONOMY PERFORMED well overall in 2003 and should continue to show growth rates of over 3 per cent in the coming years. The 2003 growth rate of 5.5 per cent was achieved in a context of increased macroeconomic stability. In 2004, inflation was kept down to 2.3 per cent; the level of external debt fell by 4.5 per cent to 31.7 per cent of GDP; and the budget deficit was kept within reasonable limits at 2.5 per cent of GDP - though the budgetary situation remains heavily dependent on revenues from privatisation.

These encouraging results are the returns of a series of reforms introduced by the Moroccan authorities in recent years aimed at deregulating the economy and improving companies' competitiveness. The objective is to get the Moroccan economy on to a sustained growth curve that will boost the wide-ranging measures put in place by the Moroccan government to improve living conditions and reduce social and regional disparities. So far economic growth and reform have not succeeded in significantly improving the living conditions of the sector of the population that lives below the poverty line, nor in sustainably reducing the dependence of the economy on the vagaries of the agricultural sector.

Significant improvements in democratisation and progress in reducing social and regional disparities have been observed.

Morocco has nevertheless made significant progress in the fields of health, education and the democratisation

Figure 1 - **Real GDP Growth**

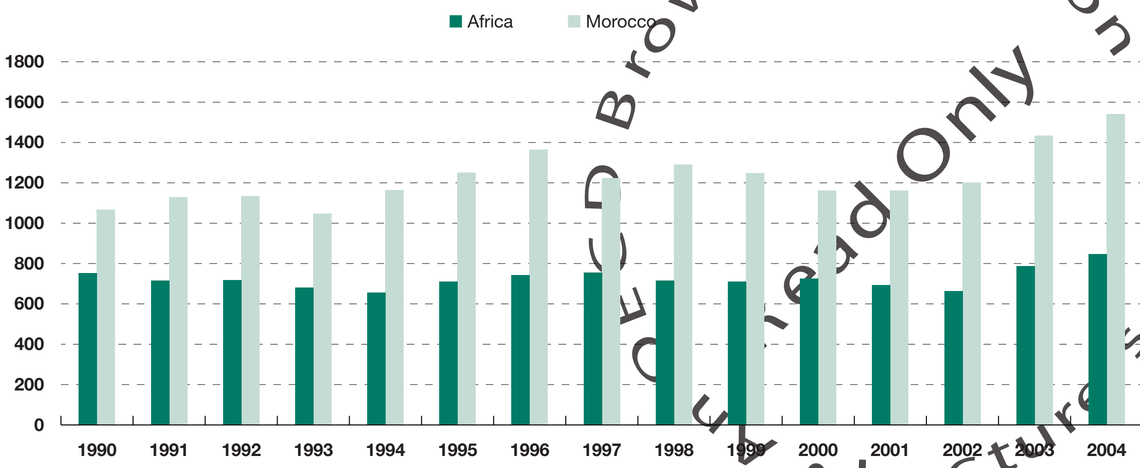
Source: National Statistics Office data; estimates (e) and projections (p) based on authors' calculations.

of public life, as well as in the strengthening of basic infrastructures, notably in favour of those least privileged in Moroccan society. All this helps to consolidate social and political stability. It is essential that these efforts be pursued so that greater advantage can be taken of the opportunities offered by the recent opening up of the country. This trend has been intensified following the signature of free trade agreements with the United States, Turkey and the Arab states of Egypt, Jordan and Tunisia.

Recent Economic Developments

The real GDP growth of 3.5 per cent in 2004 (following rates of 5.6 per cent in 2003 and 3.2 per cent in 2002) confirms the erratic economic progression caused by the country's dependence on the agricultural sector. The Moroccan authorities expect a slowdown over the next two years, with real GDP growth rates at 3.3 and 3.8 per cent respectively in 2005 and 2006. Non-

Figure 2 - **GDP Per Capita in Morocco and in Africa** (current $)



Source: IMF.

agricultural GDP growth is expected to remain at around 3 per cent.

In 2003, the primary sector registered real growth of 18 per cent (compared to 5.6 per cent in 2002) due to remarkable results in cereal production, which reached 79.6 million quintals, up by 50.9 per cent on the previous year. In 2004, cereal production totalled 83 million quintals – 4.3 per cent more than in 2003. The first quarter of 2005 has been clouded by the expectation of a fall of 4.2 per cent in the performance of the primary sector, as the cereal crop is expected to be slightly below average.

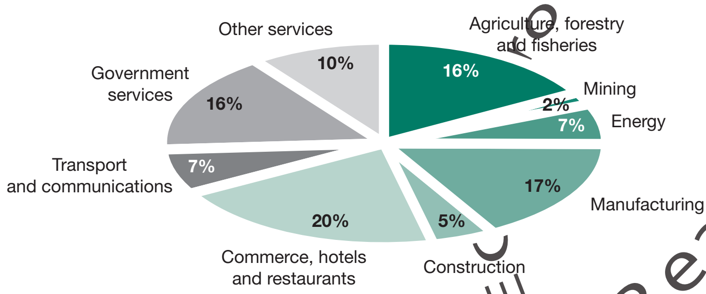
In 2004, the primary sector benefited from a good performance by livestock as a result, notably, of improved pasturage, an increase in the production of fodder crops, and the efforts made to assure the regular supply of food and veterinary products. The authorities have continued to actively support agriculture: the debts of farmers in regions affected by drought have been rescheduled, the implementation of a system of insurance for cereal production has continued, and customs duties on imported wheat, barley and corn have been increased during the period in which the harvest was marketed.

The expiry of the fishing agreement with the European Union resulted at first in a major surge in fish production, which rose from 0.7 million tonnes in 1999 to 1.1 million tonnes in 2001. This led to the depletion of stocks, in reaction to which there have been a series of extensions of the biological rest period. The Moroccan authorities expect a 2 per cent fall in real output in 2005, which will make the sector's contribution to overall growth fall from 0.3 per cent in 2004 to -0.3 per cent in 2005.

Overall, the primary sector employs 45 per cent of the total active population and 60 per cent of the active female population, while agriculture represents between 12 and 17 per cent of GDP, depending on the year and rainfall. The estimates and forecasts for 2004 and 2005 are poor: growth in agricultural output by volume is expected to be just 2.1 per cent in 2004 and virtually zero in 2005.

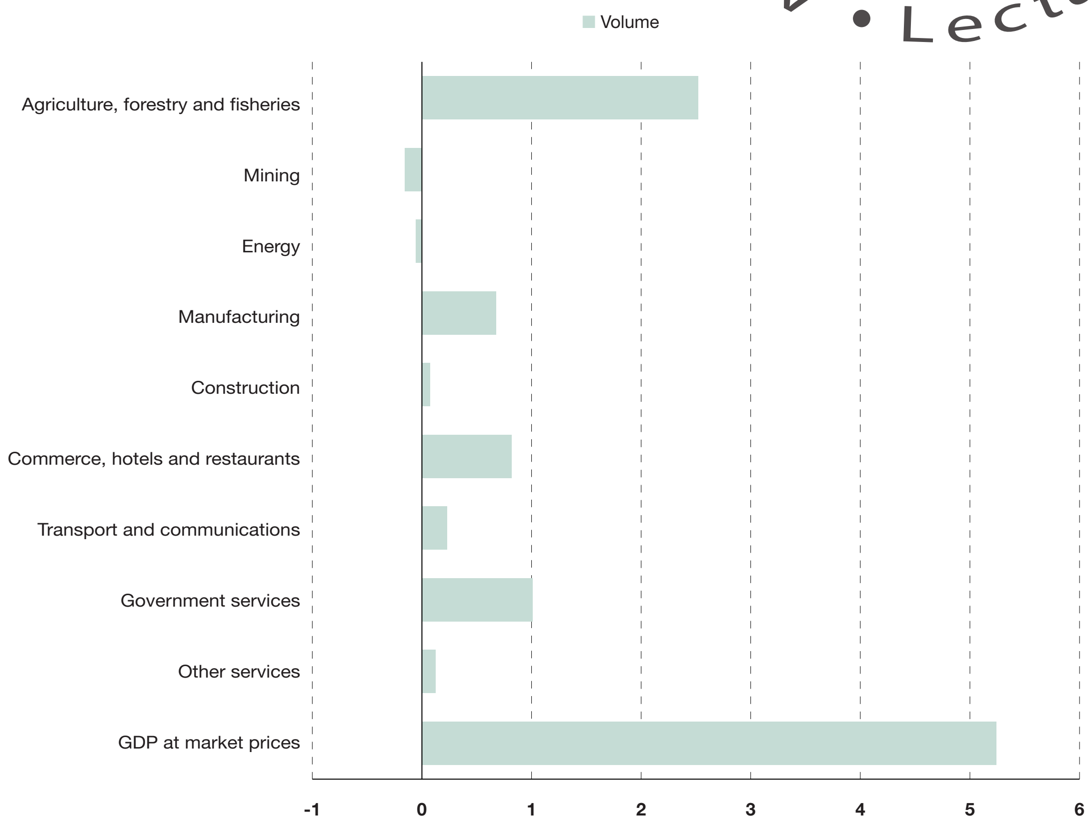
The secondary sector continued on a positive trend in 2004, particularly in mining and energy. The mining sector benefited from a favourable international climate, characterised by sustained demand. Phosphate and phosphoric acid production increased in 2004 by 9.5 and 16.4 per cent respectively. This counterbalanced a 1.2 per cent contraction in fertiliser production. Confronted with an increase in world demand for fertilisers and, in particular, for diammonium phosphate, the national phosphates company (OCP) - the world's leading exporter of phosphates and their derivatives - decided to build a new production unit at Jorf-Lasfar with an annual capacity of 850 000 tonnes, with the aim of raising total annual production to 3 million

Figure 3 - **GDP by Sector in 2003** (in percentage)



Source: Authors' estimates based on National Statistics Office data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (in percentage)



Source: Authors' estimates based on National Statistics Office data.

tonnes in 2005. In the same vein, the OCP decided to invest more than 1.1 billion dirhams in restructuring and modernising the sector. The rate of growth in the mining sector, estimated at about 4.5 per cent in 2004, should slacken somewhat in 2005 under the effect of the expected slowdown in the demand for fertilisers caused by the consolidation of world wheat stocks.

Energy production strengthened in 2004, driven essentially by increases of 11.8 and 4.5 per cent respectively in the total net production of the state electricity company (ONE) and the concessions. In 2003, energy production fell by 1.2 per cent following a 30.6 per cent reduction in refining activity resulting from a fire at the SAMIR refinery. To meet the anticipated strong increase in energy demand, SAMIR is planning to invest some 6 billion dirhams in a project to modernise the Mohammedia refinery. As for national electricity production, the ONE's investment plans provide for rural electrification, the continued construction of the Tahaddart power station and completion of the Afourer energy transfer pumping station. In 2005, the energy sector should see activity slow down as refineries return to normal production levels.

Prospects for construction and civil engineering - which depend on the rhythm of implementation of social housing programmes and of the building of basic infrastructures - look encouraging. Bank financing allotted to the sector progressed by 14.7 per cent in 2004. Forecasts for 2005 predict real growth rate of 4.6 per cent in the construction sector.

The industrial sector went through a slowdown in 2004, notably in food processing, chemicals and para-chemicals. Production levels of the textile and leather industries continued on the downward trend that started in 2003 with the end of the multi-fibre agreement. At the end of June last year, there was a further reduction of 1.5 per cent, following the 3 per cent fall that was seen in 2003. The sector should nevertheless benefit from the free trade agreement between Morocco and the United States, which gives Moroccan textile products easier access to the American market and encourages direct foreign investment. The Spanish group Tavex plans to invest 630 million dirhams on the expansion of its Moroccan subsidiary (which specialises in the production of jeans and sportswear) so as to take advantage of the opportunities offered by the American market.

In 2003 the authorities set up a nationwide agency designed to support small and medium-sized companies (ANPME) by making them more dynamic and competitive. The ANPME is charged with piloting the national programme for upgrading this type of company in the fields of consulting and technical assistance, fiscal harmonisation, and the simplification of administrative procedures. Following the creation in February 2003 of the ***Fonds de restructuration du textile*** (FORTEX), which was set up to aid textile companies facing financial difficulties with restructuring programmes, in July of the same year the authorities set up the ***Fonds national de mise a niveau*** (FOMAN), the role of which is to provide up to 80 per cent of the cost of technical assistance in the industrial sector and to participate – along with the banking sector – in the financing of investments. In the course of 2004 the secondary sector experienced real growth in the order of 3.5 per cent, with 3.2 per cent growth in the manufacturing industries alone. In 2005, the growth rate for the secondary sector should be 3.8 per cent and 3.4 per cent for the manufacturing industries.

The number of tourists topped a record 5.5 million in 2004 -16 per cent up on the preceding year's figures. This success was largely due to an increase of 27 per cent in the number of tourists from Western Europe, by far the country's biggest market. The French remain in first place with more than 1.16 million visitors (+27 per cent), followed by the Spanish (333 028 visitors), the British (169 152), the Germans (146 269), the Italians (112 807) and the Belgians (105 821). The number of Moroccans living abroad (MRE) who spent their holidays in Morocco came to 2.7 million in 2004: this figure represents about half the total number of MREs, and 9 per cent more than in 2003. In 2004, the imperial city of Marrakech was the principal destination for foreign tourists, followed by Fès in the east, Agadir in the south, Ouarzazate in the south-east and Casablanca, the business capital. The Moroccan authorities are pleased with this result, particularly given the economic situation in Europe, the crisis in the Gulf and, above all, the attacks that took place in Casablanca on 16 May 2003. The kingdom has adopted a national tourism development plan with the aim of receiving 10 million foreign visitors by 2010. Hotel capacity has already risen from 1 500 beds per year between 1996 and 2000 to over 8 000 new beds between 2003 and 2004.

The authorities have decided to increase the size of the national aircraft fleet and to deregulate air transport. The national company plans to spend 16 billion dirhams before the end of 2010 to buy 24 new aircraft, 4 of which were delivered in 2003.

The merchant service sector registered real growth

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**19.6**	**22.9**	**22.7**	**23.2**	**22.8**	**23.8**	**24.3**
Public	3.1	2.9	2.7	2.6	2.7	2.8	2.9
Private	16.5	20.0	20.0	20.6	20.1	21.0	21.4
Consumption	**83.8**	**80.4**	**80.4**	**81.3**	**76.7**	**76.1**	**75.7**
Public	16.9	19.8	19.5	19.9	20.0	19.9	19.5
Private	66.9	60.6	60.9	61.3	56.7	56.3	56.3
External Sector	**-3.4**	**-3.3**	**-3.1**	**-4.4**	**0.6**	**0.1**	**0.0**
Exports	26.3	32.9	33.8	31.1	35.2	36.1	35.8
Imports	-29.6	-36.2	-36.9	-35.5	-34.6	-36.1	-35.8

Source: National Statistics Office data; estimates (e) and projections (p) based on authors' calculations.

of 3.5 per cent in 2004, to which the commerce, transport and communications and other merchant services contributed with growth rates of 4.2, 3.3 and 1.8 per cent respectively. The contribution to real GDP growth was 1.3 per cent in 2004.

Overall, the service sector can expect 4.2 per cent growth in 2005, thanks to a recovery in tourist activity and an improvement in commerce, transport and communication.

As for the composition of demand, the value of final consumption - estimated at 76.7 per cent of GDP in 2004 - is expected to increase by 5.3 per cent in 2005. This optimism is based on a growth in the revenues of rural households resulting from an improved agricultural season, as well as on the increase in investment in housing and durable goods that has followed from the lowering of interest rates and the mechanisms created by the authorities to facilitate access to cheap housing. Consumption should make up 76.1 and 75.7 per cent of GDP respectively in 2005 and 2006. Gross fixed capital formation should increase by 8.7 per cent in 2005, lifting the investment rate from 22.8 per cent in 2004 to 23.8 per cent in 2005 and 24.3 per cent in 2006. These prospects are favourable for future growth.

Macroeconomic Policies

Fiscal and Monetary Policy

The Moroccan authorities have a delicate budgetary challenge on their hands: reducing the budget deficit by juggling between the decrease in revenue that will follow the removal of duties and the inevitable slow-

Table 2 - Public Finances (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**23.5**	**31.1**	**25.0**	**27.0**	**26.7**	**26.7**	**26.6**
Tax revenue	20.7	22.7	22.9	22.1	21.6	21.7	21.6
Grants	0.0	0.1	0.1	0.1	0.3	0.2	0.2
Total expenditure and net lending[a]	**26.5**	**30.7**	**29.4**	**29.6**	**29.2**	**29.1**	**28.7**
Current expenditure	21.3	25.4	24.7	25.0	24.5	24.3	23.7
Excluding interest	*15.9*	*20.5*	*20.3*	*20.9*	*20.9*	*20.8*	*20.4*
Salaries	10.5	12.5	12.2	12.7	12.5	12.3	12.0
Interest	5.4	4.9	4.4	4.1	3.6	3.5	3.3
Capital expenditure	4.9	5.2	4.7	4.6	4.7	4.9	5.0
Primary balance	**2.4**	**5.3**	**0.0**	**1.6**	**1.1**	**1.0**	**1.2**
Overall balance	**-3.0**	**0.4**	**-4.4**	**-2.5**	**-2.5**	**-2.4**	**-2.1**

a. Only major items are reported.

Source: Ministry of Finance and Privatisation data; estimates (e) and projections (p) based on authors' calculations.

down in the number of privatisations, while at the same time containing expenditure without compromising the objectives of reducing poverty and unemployment.

Ordinary revenue, excluding Treasury special accounts, totalled 109 444 billion dirhams in 2004. This increase of just 3.6 per cent is due to a 27.8 per cent reduction in privatisation revenues. Fiscal revenue increased by nearly 3.3 per cent in 2004 following an 8.2 per cent increase in direct taxes (compared to a rise of 9.3 per cent in the previous year), and a 1.6 per cent rise in indirect taxes. Customs duties fell 12.8 per cent in 2003 and 4 per cent in 2004, mainly as a result of the implementation on 1 March 2003 of the fourth round of reductions in duties stipulated in the partnership agreement with the EU. The reduction is also the result of a lower than expected increase in imports. These movements led to a slight reduction in fiscal pressure, which descended from 22.1 per cent in 2003 to 21.6 per cent in 2004. Privatisation revenue, which came to nearly 5.7 billion dirhams in 2003, could rise again considerably in 2005.

Total expenditure increased 3.5 per cent from 114 932 billion dirhams in 2003 to 118 880 billion dirhams in 2004. This rise takes into account a 4.8 per cent increase in ordinary expenditure in 2004 and, more particularly, an increase of nearly 7.4 per cent in spending on goods and services and of about 6.9 per cent in personnel costs. The increase in compensation charges in 2004 is essentially due to support for butane gas prices, tied to the increase in oil product prices. In 2004 expenditure from the Hassan II fund (a special fund which draws mainly on privatisation revenue to finance heavy investment in infrastructure and the social sectors) amounted to 4.4 billion dirhams or 1 per cent of GDP.

The overall evolution of revenue and expenditure resulted in a budget deficit in the 2004 financial year representing 2.5 per cent of GDP, the same as in the previous year. Excluding privatisation revenues, the budget deficit was reduced from 5.2 per cent in 2003 to 4.4 per cent in 2004, compared with an initial forecast of a reduction of 5.7 per cent. At the end of December 2004, outstanding direct Treasury debt stood at 67.6 per cent of GDP, compared with 68.2 per cent in 2003. The budget deficit could be reduced to 2.4 per cent in 2005 and further to 2.1 per cent in 2006, including privatisation revenue.

Faced with persistent excess liquidity, the ***Bank Al Maghrib*** (the central bank) revised upwards its rate of remuneration for liquidity absorption from 3 to 3.25 per cent, and its monetary reserve rate from 14 to 16.5 per cent, while at the same time offering banks the opportunity to make currency swaps. In this context, the growth in money supply (M3) at the end of 2004 was 8.3 per cent, compared with 8.7 per cent in 2003. Analysis of M3 subsidies show a further 7.8 per cent increase in net external credit (compared with 15.1 per cent in 2003), a 0.7 per cent increase in internal credit growth to 6.6 per cent (compared to 5.9 per cent in 2003), an 8.6 per cent rise in lending to the economy (compared to 8.7 per cent in 2003), and an increase of net lending to the state of 1.3 per cent (compared to -2.7 per cent in 2003). This increase in money supply led to a liquidity level (M3/GDP) in 2004 that was again very high - at 89 per cent – compared to 92.3 per cent in 2003, a figure that partly reflected the efforts of ***Bank Al Maghrib*** to reduce the effects of this excess liquidity.

After four years of poor performance, the Casablanca stock exchange returned to growth in 2003. The Moroccan All Shares Index and the Moroccan Most Active Shares Index rose 32.3 and 26.3 per cent respectively in the course of the year. However, these two indexes fell again at the end of 2004 under the impact of the high level of market prices and the publication of poor results by certain companies.

The inflation rate in 2004 was 2.3 per cent, compared to 1.2 per cent in 2003. The increase in the price of crude oil on the international market led to the Moroccan government deciding to increase prices for oil products in August 2004. Since 25 August a litre of petrol costs 8.98 dirhams (0.81 euros), as compared to 8.65 dirhams before the price increase, and a litre of ordinary diesel fuel costs 5.96 dirhams (0.54 euros), compared to its former price of 5.76 dirhams. The inflation rate in 2005 should come close to 2.6 per cent as a result of the increase in the price of food products and the upsurge in oil prices. The rate should fall to 1.8 per cent in 2006.

The national currency depreciated by 3.9 per cent in relation to the euro in 2003 and by 1.8 per cent in 2004. The dirham appreciated, however, by 15.1 per cent in relation to the dollar in 2003 and by 8 per cent in 2004. This trend is favourable to the development of exports from Morocco to the EU, its leading trading partner.

External Position

The period from 2002 to 2004 was characterised by the pursuit of a policy of opening up and integration of the Moroccan economy. In October 2003, Morocco signed a new agreement with the EU, which this time focused on the agricultural sector. On the European side, the agreement staggers the timetable for the removal of trade tariffs and provides for an increase in tomato export quotas from 170 000 to 220 000 tonnes over a period of four years. On the Moroccan side, there is a commitment to importing between 400 000 and 1 million tonnes of European wheat, depending on the level of the national harvest. In addition, Morocco signed free trade agreements in 2004 with Egypt, Jordan, Tunisia and Turkey. These agreements form part of the Barcelona process for the construction of a Euro-Mediterranean zone. Finally, Morocco concluded a free trade agreement with the United States in March 2004. Through these agreements, the Moroccan authorities are seeking to diversify their external trade so as to take advantage of the recovery in the international economy and to protect themselves against any future slowdowns in the European economy.

Moroccan exports - which brought in only 10 billion dirhams in 2004 - showed a very small increase, and their share of GDP fell 1.6 per cent to 18 per cent. The recovery in the activity of SAMIR in 2004 resulted in a 104.1 per cent increase in sales of energy and lubricants abroad. Exports of phosphates and their derivatives increased by 22 per cent over 2003 to reach 14.5 billion dirhams (1.31 billion euros). These good performances partly compensated for the poor results in the value of exports of electrical, textile and agricultural products. The fall in the sales of agricultural and fish products was to blame for the decline in the contribution of food exports to total export growth. The value of exports of electrical and electronic products also declined in 2004, following the 8.7 and 0.9 per cent drop in the respective values of sales of electric wiring and cables, and electronic components. Exports of the main products of the textile sector – ready-made clothes and hosiery – fell in value by 0.7 and 6.2 per cent respectively. Exports are expected to make up 18.3 per cent of GDP in 2005 and 18.1 per cent in 2006. Most of these exports go to the European market (75 per cent), with just 1.5 to 2 per cent of the country's exports going to the countries of the Arab Maghreb Union. France and Spain are Morocco's two principal trading partners for both imports and exports.

The increase in the price of crude oil on international markets provoked a 57.7 per cent increase in the cost of crude oil imports in the balance of trade in 2004: these imports cost the country 14.5 billion dirhams (1.31 billion euros). Morocco imports virtually all the products it needs to cover its energy requirements. The average cost per tonne imported increased 19.3 per cent in 2004, rising from 1 999 to 2 384 dirhams (215 euros). The overall volume of petrol imports rose, moreover, from 4.61 million tonnes in 2003 to 6 million tonnes the following year, representing an increase of more than 30 per cent. The increase in the volume of crude oil imports was the result of the return to full activity of SAMIR, the country's only refinery. Altogether, the increase in purchases of crude oil and an 11 per cent increase in the value of non-oil products seriously worsened Morocco's trade deficit.

Morocco's trade was marked by a 34 per cent deterioration in the trade deficit, resulting from a sharp 14.1 per cent increase in imports to 15 billion euros and a moderate 2.1 per cent rise in exports to 8 billion euros. The import cover rate stood at 55.2 per cent compared to 61.7 per cent in 2003 – a decline of 6.5 per cent. Under the effect of the increase in the value of imports, the trade deficit should increase this year to reach 11.8 per cent, and 11.9 per cent in 2006.

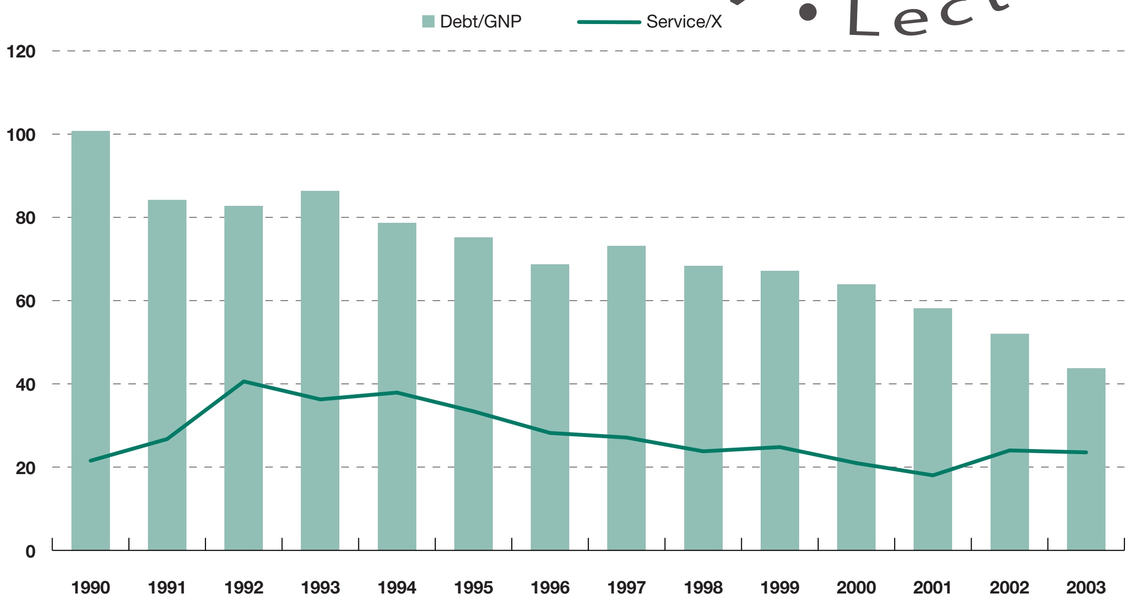
Despite this aggravation of the trade deficit, the Moroccan economy finished the year with a current

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-7.7	-8.9	-8.5	-9.9	-10.9	-11.8	-11.9
Exports of goods (f.o.b.)	18.8	21.1	21.7	19.6	18.0	18.3	18.1
Imports of goods (f.o.b.)	-26.5	-30.0	-30.2	-29.5	-28.8	-30.2	-29.9
Services	2.6	3.2	3.3	5.8			
Factor income	-3.6	0.2	0.4	-1.7			
Current transfers	7.0	10.3	8.9	9.4			
Current account balance	**-1.7**	**4.8**	**4.1**	**3.7**			

Source: Ministry of Finance and Privatisation general economic policy department data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

account surplus of about 1.3 per cent of GDP. This positive result comes from a 10 per cent increase in tourist revenues over 2003 (more than 300 million euros) and a 7.1 per cent rise in transfers from Moroccans living abroad (3.7 billion euros). In 2005, for the fifth consecutive year, the current account should be in surplus by around 1.3 per cent of GDP despite the aggravation of the balance of trade deficit.

In 2004, the capital and financial operations account registered a surplus representing 0.1 per cent of GDP. The overall balance was in surplus for the fourth consecutive year, with a positive balance of close to 1.3 billion euros. The reduction in the level of external debt continued, finishing at 31.7 per cent of GDP compared to 36.2 per cent in 2003, and official reserves increased by nearly 12 per cent to reach 15.2 billion euros or the equivalent of 9.8 months of imports at the end of December 2004.

Structural Issues

The rhythm of the major structural reforms, which are helping to accelerate growth, has been intensified since 2002. Private and public operators are co-operating to offer companies a favourable and attractive environment. Morocco's legal and fiscal framework is moving closer to the requirements set by international conventions. The Investment Charter and the relaxation of exchange controls include measures that reinforce the opening of the national economy towards the exterior. Three fundamental freedoms have been underlined – the right to invest, the right to transfer profits and the right to transfer capital gains under certain conditions. Efforts to improve the environment are continuing through the introduction of measures designed to encourage private initiative. The Hassan II Fund provides financial aid for the acquisition of land and/or the construction of production units. An offshore financial centre has been opened for banks and certain holding companies. The state has also reinforced the protection of industrial property.

Small and medium-sized companies (SMEs) and industries constitute the underlying fabric of the Moroccan economy. They make a significant contribution to economic growth, job creation and local and regional development. In 2002, SMEs represented 93 per cent of Moroccan industrial companies, 38 per cent of industrial production, 33 per cent of industrial investment, 30 per cent of industrial exports and 46 per cent of industrial employment. Out of the 7 200 industrial companies registered in 2002, 38 per cent were micro-companies employing less than 10 people, 38 per cent small companies employing between 10 and 49 people, 17 per cent medium-sized companies employing 50 to 199 people, and 7 per cent big companies employing more than 200 people. The three sectors with the greatest number of companies are chemicals and para-chemicals, textile and leather, and food processing.

The small and medium-sized companies charter[1] was established in law 53-00 in July 2002. It represents the framework of reference for action taken to support SMEs, from financing and training to infrastructures and fiscal incentives for investment. The charter set up the ANPME and created an improved framework for associations supporting small and medium-sized companies. Since 2002, aid for the creation of companies has been offered via 16 regional investment centres. The principle mission of these centres is to simplify procedures through the use of a single company creation form. Among the support measures set out in the charter are: state aid for the use of information and consultancy services, technical assistance and expertise and management training, improved conditions concerning real estate, fiscal incentives in the form of deductions, reductions and tax exemptions and, finally, new financing measures. Different financing bodies have been set up for SMEs, these include collective capital investment funds, capital investment companies, regional financing companies, mutual and co-operative credit organisations, and risk-capital bodies and companies. The state also participates in the financing of certain actions and transactions to help young entrepreneurs through the fund for the promotion of youth employment (FPEJ). In addition, it also grants subsidies to professional and other bodies involved in the provision of training, information and assistance in the conception, evaluation and administration of investment projects. Indirect financial aid is provided for SMEs by general or sectoral guarantee funds. Guarantee funds specific to the needs of very small and innovative companies have been set up.

The ANPME has decided to make 2005 a year of consolidation for company upgrading. In 2004, the agency's action consisted above all of providing direct aid to companies, and assistance to their support structures. The report on projects carried out directly by the ANPME shows that 524 companies agreed to take part in the upgrading process, of which 314 have already been assisted and 97 are in the process of getting started..

The development of micro-credit began rather tentatively in the 1990s with small loans destined to

1. This charter defines small and medium-sized companies as being businesses managed and/or administered directly by their owners, co-owners or shareholders; in addition, no more than 25 per cent of the companies capital may be held by one or more business that is not classed as small or medium-sized. The workforce of SMEs must be below 200 and their turnover must not exceed an average of 75 million dirhams over two years. Companies which have existed for less than two years must have an investment programme amounting to not more than 25 million dirhams and keep to an investment ratio of less than 250 000 dirhams per employee.

Financial Innovation in the Moroccan Banking System

The Moroccan banking system has a variety of financing options to help promote investment and company creation, with lending rates being freely negotiated between banks and entrepreneurs. Traditional bank loans cover up to 80 per cent of companies' needs with specific credit lines financing 70 per cent of the cost of restructuring programmes for SMEs. Loans to help self-employed young promoters and entrepreneurs have been created to promote the integration of young people into working life and reduce unemployment. The "Young Promoter" loan, which is destined for higher education and professional training graduates, was replaced in February 2003 by the "Young Company Creation" scheme, guaranteed up to 85 per cent by the state. In addition, leasing for the acquisition of capital equipment or property for professional use guarantees the rental and financing up to 100 per cent of the cost of acquisition. Capital investment – risk capital, development capital, start-up capital, transmission capital and restructuring capital – provides SMEs with fresh capital at different stages of their development cycle. They represent a form of financing that is paid for not through interest but by a capital gain at exit or by dividends. Capital investment also has the advantage of providing – as the basis for mobilising funds – technical assistance, advice and surveys. Under certain conditions, seven-year loans can be granted as part of an extension to a new partner or a shareholder. The initial loan and the new loan together cannot exceed 1 million dirhams for a single project and 3 million dirhams for companies or co-operatives. Loans are covered by a guarantee fund that assures 85 per cent of reimbursement of principal, plus normal interest and, if the case arises, late payment interest payments. Finally, with regard to micro-lending and within the framework of the upgrading programme, European credit lines – French, Italian, Spanish and Portuguese – and the Islamic Development Bank have contributed to national financing resources for the development of SMEs.

finance the economic activities of people with low revenues. In 1998, in collaboration with the United Nations Development Fund, the government set up the Microstart programme. This programme makes use of the capacities of local associations to provide micro-financing services on a durable basis. Microstart turned out to be a precious tool for the development of micro-credit activity and the government therefore took steps to organise the programme more effectively. A law was promulgated in 1999 to legalise the activities of associations specialising in micro-credit and setting out the conditions under which such organisations should be set up and run. To ensure the openness of their operations, the law requires micro-credit associations to keep accounts, to undergo annual external audits and to present five-year financial projects when they apply for authorisation start their activities. In addition, the law stipulates that associations can borrow on the open market and receive public and private subsidies without collecting savings. It also grants the associations exemptions from tax over 5 years and gives donors fiscal advantages. In this context of state support, and given the high level of demand, the micro-credit sector has developed considerably over the last four years. According to the national federation of micro-credit associations, the number of beneficiaries at the end of 2000 was no more than 125 000 for loans totalling less than 200 million dirhams, while at the end of September last year, the total amount distributed in micro-credits had reached 5 billion dirhams, itself an increase of 47 per cent over the 2003 total of 3.4 billion dirhams. The number of active clients stood at 403 000, of which 71.3 per cent were women, and the level of loan reimbursement was 90 per cent. The bulk of these loans – 87.6 per cent – were distributed in urban and suburban zones. Rural areas accounted for only 12.4 per cent of micro-credits. The main sectors to benefit from these loans were textiles and commerce, with respectively of 34.3 and 23.1 per cent of the total number of loans granted. Micro-credit associations are also going to be receiving both international and local financial support. The latter, in so far as public money is concerned, will be transiting through the Hassan II Fund. A convention for $10 million was signed in December 2004 between the ***Société Générale Marocaine des Banques*** and the US Agency for International Development (USAID); a second credit line for 110 million dirhams was opened by the European Investment Bank.

The reform of the banking and financial system has also continued, with the aim of improving the efficiency and the quality of company financing. In 2004 two major bills were adopted relating to the statutes of the ***Bank Al Maghrib***, credit establishments and assimilated bodies. This legislation establishes greater flexibility in monetary regulation, while respecting the new regulatory and accounting requirements of the Basle II agreement. The project concerning the central bank involves a fundamental revision of its statutes: it establishes a new organisational, management and control framework, as well as the principle of separation of executive and monetary functions. The new text reinforces the autonomy of the central bank in the conduct of monetary and exchange policy and gives it the right to prohibit loans to the state and public establishments, excluding exceptional cash facilities under restricted conditions. The new banking law extends the field of the central bank's supervision duties to all financial institutions; it also reinforces the role of auditors and develops institutional co-operation in the supervision of the financial sector. Over the past two years the restructuring and rehabilitation of the financial institutions has been focused on the public sector banks – ***Banque Nationale de Dévéloppement Economique***, ***Crédit Agricole du Maroc*** and ***Crédit Populaire du Maroc***. At the same time, structural reforms concerning - in particular - the Treasury Bond market by adjudication and modernisation of the stock exchange, were launched in 2003 and 2004 with the aim of making the capital markets more efficient and increasing their contribution to the financing of the economy.

The authorities have programmed the deregulation of particular sectors of economic activity. The deregulation of the electricity sector is planned for 2005 and should lead to the establishment of both a regulated market and a free market that will share access to the transport network of the ONE. In the field of transport, the state railway company, the ***Office Nationale des Chemins de Fer*** has become the ***Société Marocaine des Chemins de Fer***, the former public body is now a joint stock company, which opens the way to deregulation of the management of the railways through management concessions for railway infrastructures and operations. As for ports and shipping, a reform is planned which will split the ***Office d'Exploitation des Ports*** into two entities: the ***Agence Nationale des Ports***, which will play the role of port authority, and the ***Société d'Exploitation des Ports***, which will have responsibility for commercial functions, the introduction of competition between and within ports, and the unification of cargo-handling services. A new deregulation policy has been instituted in air transport. It is founded on the objectives set out in the ***Plan Azur*** (notably increasing the number of passengers transported to 15.6 million by 2010) and aims at deregulation of the regular flight market taking place on a controlled and voluntary basis, as well as a limited deregulation of the charter market.

In the telecommunications sector, announcement of the sale of a second fixed telephone licence in 2004 did not attract much attention because of the explosion of the portable telephone market. In addition, market regulations prevented the sale from taking place before 2005. In 2004, ***Maroc Télécom*** reported a 12.8 per cent increase in turnover. Portable telephones earned it more than 10 billion dirhams (900 million euros), with turnover rising by 21 per cent on 2003 levels. The number of its clients rose to 6.4 million. However, its turnover for fixed telephones and Internet services stagnated at around 11 billion dirhams (1 billion euros), despite the success of broadband Internet, the number of subscribers for which rose from 2 600 at the end of 2003 to 60 000 at the end of 2004. ***Maroc Télécom*** was privatised in 2004 and listed simultaneously on the Paris and Casablanca stock exchanges in December 2004. The operation was the biggest stock exchange flotation in Morocco's history.

At the end of 2004, about half the 114 public companies targeted for privatisation in 1993 had been sold. The principal privatisations carried out in 2003 and 2004 were the 14 billion dirham sale of 80 per cent of the capital of the ***Régie des Tabacs*** tobacco company and the 95 million dirham transfer in July 2004 of 26 per cent of the capital of the SOMACA automobile construction company. Other privatisations were carried out at the end of 2004: the fertiliser producer FERTIMA was sold for 14.1 million dirhams, SONIR the printing works for 22 million dirhams, and a 40 per cent stake in the capital of the COMANAV shipping company was also sold off.

The government is also going to have to tackle the reform of the retirement system. Two public bodies currently manage retirement pension financing – the Moroccan retirement fund (CMR) for civil servants, and the military and the national social security fund (CNSS) for private sector employees. Despite the increase in contributions decided in 2002 and 2003 to improve the financial situation of the CMR – up from 7 to 10 per cent for civil servants and from 7 to 14 per cent for the military -, it seems likely that the two bodies will remain in deficit up to around 2010. Serious measures must be taken if the system is to remain solvent in the medium term. The World Bank has offered to help the Moroccan authorities to define the most efficient way of achieving this aim.

Political and Social Context

The beginning of the reign of King Mohammed VI constituted a crucial stage in the process of political transition and marked the beginning of a real democratisation of political life. Apart from renewing the political leadership, King Mohammed VI has taken a number of highly symbolic decisions such as the creation of a consultative committee for human rights, the reform of the code of civil liberties, the reform of broadcasting via the creation of the higher council for audiovisual communication, the adoption of a law abolishing the state monopoly in radio and television broadcasting, and the consolidation of minority rights. The creation in January 2004 of the equity and reconciliation authority (IER), a commission composed of former political detainees and human rights activists, should make it possible to investigate past exactions and violations.

The major event in terms of the modernisation of society is without doubt the reform of Family Law (the ***moudawuna***) and its transformation into the family code, which was adopted unanimously by the chamber of deputies and published in the official bulletin on 5 March 2004. This reform seeks to assure the judicial, legal and administrative protection of the family as an institution; to place areas such as polygamy, divorce and repudiation, and child custody and maintenance payments under judicial control; to promote equality between men and women in the field of family responsibilities, and to set out the mutual rights and duties of husbands and wives. In 2004 a national strategy for the protection of children's rights was created. Finally, Morocco carried out several reforms aimed at improving governance and relations between the government and citizens, including the creation of an independent mediatory body, ***Al Wassit***.

In the course of the last few years the government has introduced policies to fight against poverty. In 2001, nearly 5.4 million Moroccans were living beneath the poverty line. There have been a number of structural social reforms dealing with education, health, housing, living conditions and employment. Government action in this field has benefited mostly urban areas, where the poor made up 9.6 per cent of the population in 2001, compared to 12 per cent in 1998. Poverty in rural areas, however, increased from 27.2 per cent in 1998 to 28.8 per cent in 2001.

A new employment code came into force in June 2004 aimed at regulating relations between employees, employers, unions and state bodies active in the employment field in a clear and open manner. Despite an improvement of more than 2 per cent in the level of economic growth, job creation regressed by 9.8 per cent. Unemployment rose from 11.6 per cent in 2002 to 11.9 per cent in 2003, affecting 1.3 million people. The increase in unemployment was more marked among women than among men, deepening the existing inequality between the two groups. In 2003, young people were seriously affected by unemployment, with graduates (24 per cent) relatively worse affected than non-graduates (5.7 per cent). However, between the third quarter of 2003 and the third quarter of 2004, the level of unemployment diminished from 12.3 per cent to 10.9 per cent.

Measures aimed at improving the living conditions of the population generally – and the least privileged categories in particular –, such as the promotion of social housing and rural infrastructures, are starting to bear fruit. For example, the "Cities Without Shantytowns" (PVSB) programme was launched in 2003 with the aim of ridding 67 cities of urban shanty towns by 2008 (a total of 201 550 households). In 2004, the first phase covering the 12 most problematic cities in the country got underway. At the same time, two guarantee funds were set up in December 2003 to facilitate access to property for the population at large, but particularly for households on low and irregular incomes, by enabling them to benefit from bank loans. The first fund provides bank loans for civil servants for the acquisition or the construction of social housing, while the second grants loans to people on low and irregular incomes.

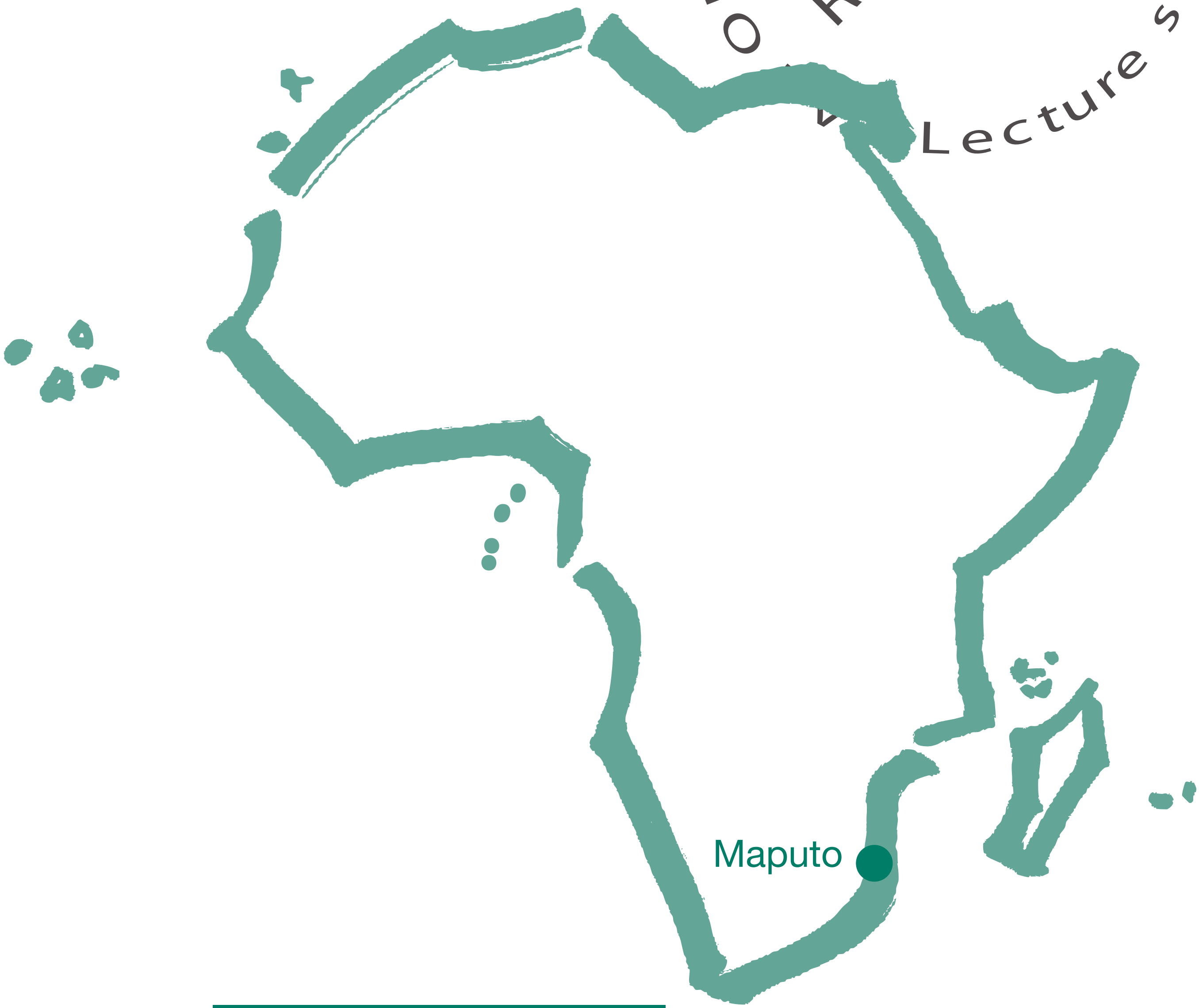
Major programmes have been launched in recent years in the framework of the application of the rural development strategy. The integrated rural development programme for the enhancement of the Bour zones (DRI-MVB Project) aims to reduce vulnerability to drought in six priority regions. The national programme for rural roads seeks to consolidate efforts undertaken to reduce the isolation of rural areas. The programme for the collective supply of water in rural areas (PAGER) and the programme for global rural electrification (PERG) – launched in 1995 and 1996 respectively – have been accelerated, helping to increase the level of access to drinking water and level of electrification in rural areas to 55 and 90 per cent respectively in 2003.

In the health care sector, the Ministry of Public Health's budget has doubled over 10 years to reach 5.18 billion dirhams (nearly 5.3 per cent of the total budget spending) in 2003. Over the same period, investment spending increased by an average 5.7 per cent per year, leading to a significant improvement in the supply of health infrastructures and equipment, particularly in the local care sector. The number of basic health establishments, which stood at 2 405 in 2002, grew at a rate of 3.5 per cent per year between 1980 and 2001, while the number of patients per doctor fell from 3 087 in 1993 to 1 845 in 2003.

Between 1998 and 2002, life expectancy at birth increased by more than 1 year from 69.2 to 70.3 years. The death and infant mortality rate fell to 5.8 and 36.6 per 1 000 respectively. The level of vaccination cover for infants between the ages of 12 and 23 months reached 87.1 per cent for the three basic vaccines. Despite the progress made, the last study of household living standards - carried out between 1998 and 1999 - showed that more than 34 per cent of sick people did not seek treatment, a level that reached 55 per cent in the poorest fifth of the population. To remedy this problem, a 2002 law established two health insurance regimes: AMO, the obligatory health insurance scheme for public and private sector employees and their dependents, and the medical assistance regime, RAMED, for the most deprived population categories. Finally, two new projects were initiated: the health sector management support project (PAGSS), financed by the European Union as part of the MEDA programme (the EU's financial instrument for the implementation of the Euro-Mediterranean partnership), and the health sector financing and management project (PFGSS), funded by the World Bank.

In education, the government has taken on some of the Millennium Development Goals including, notably, the eradication of illiteracy among 15 to 24 year olds. Illiteracy currently affects about 35 per cent of this age range and nearly 48.3 per cent of the population over the age of 10. Women and the rural population are particularly affected, with rates of 61.9 and 66.9 per cent respectively. A new literacy campaign - ***Massirat Annour*** - was launched in May 2003 which it is hoped will, over time, help up to 1 million people per year. Several steps have been taken to give the campaign a national dimension and to involve as many relevant bodies as possible, including regional education and training authorities, local offices of the ministry of education and youth, and non-governmental organisations. Strategically, the improvement of human capital and its qualifications – which necessitates a reform of the education system – is indispensable to the development of the Moroccan economy. The first results of the reform launched in 2000 with the adoption of the charter for education and training are a little behind target. This is the result of the year's delay in its application. They remain encouraging nevertheless, as is demonstrated by the rise in net levels of school attendance among children aged 6 to 11, from 69 per cent in 1997/98 to 92.2 per cent in 2003/04 at national level, from 55.4 to 87.8 per cent in rural areas and from 44.6 to 83.1 per cent for girls in rural areas. At secondary school level, the level of school attendance among children aged 12 to 14 also shows a marked improvement, rising from 53.7 per cent in 1997/98 to 68.8 per cent in 2003/04. In the rural areas, this level increased from 29.7 per cent in 1997/98 to 50.1 per cent in 2003/04, while school attendance among girls in this age group virtually doubled over the period to 41.9 per cent. The reform of higher education, also dealt with in the charter, seeks to reduce the drop-out rate – in 1999, only 10 per cent of students obtained a degree after four years – in order to improve the uptake of graduates on the employment market and to bring the level of the education system back up to international standards.

Mozambique



key figures

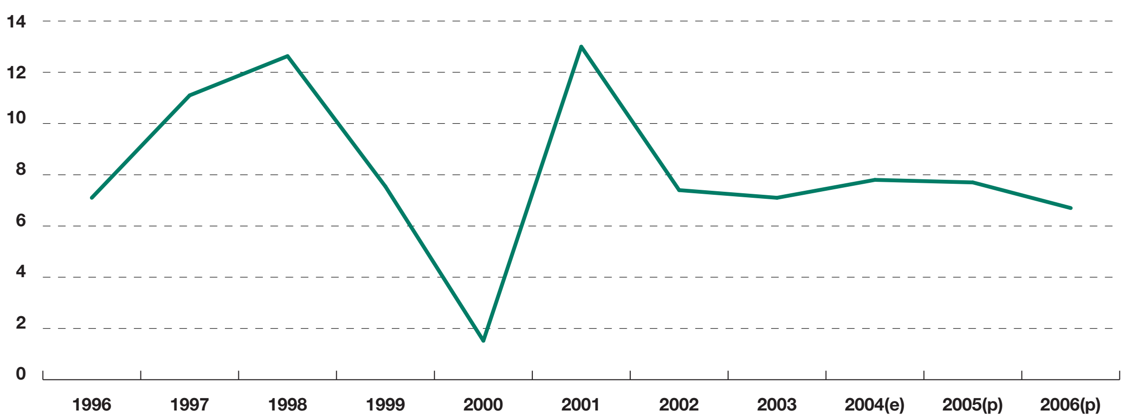
• Land area, thousands of km²	802
• Population, thousands (2004)	19 182
• GDP per capita, $ (2003)	229
• Life expectancy (2000-2005)	38.1
• Illiteracy rate (2004)	50.9

SINCE THE END OF A DEVASTATING WAR in 1992, Mozambique has recorded one of the world's highest growth rates, averaging 8.1 per cent from 1993 and continuing in 2003 and 2004. Owing to high population growth and the very low initial level in 1993, however, Mozambique's per capita income remains among the lowest in the world at $229 in 2003. Poverty has decreased sharply but more than 50 per cent of the population is still classified as poor, and income and wealth inequalities remain pervasive and may indeed have risen geographically. Much of Mozambique's growth comes from a few large foreign ventures (the "mega-projects"), while little has been done to create broader-based growth and competitive productive capacities. In addition, Mozambique must confront a serious and deteriorating problem of HIV-AIDS and a severe human resources deficit.

Real GDP growth reached 7.1 per cent in 2003 and is estimated to have increased to about 7.8 per cent in 2004, mainly as a result of the two foreign-owned mega-projects – the Sasol gas pipeline and Mozal II expansion of the aluminium smelter. If confirmed, this outcome is in line with the 8 per cent growth target under the Poverty Reduction Strategy Paper (PARPA) for 2001-05. GDP growth is projected to average 7.7 per cent in 2005 and to fall off slightly to 6.7 per cent in 2006. However, concerns remain regarding the sustainability of this

High economic growth is projected with the coming on stream of mega projects but redistribution and poverty reduction need to be tackled.

Figure 1 - **Real GDP Growth**



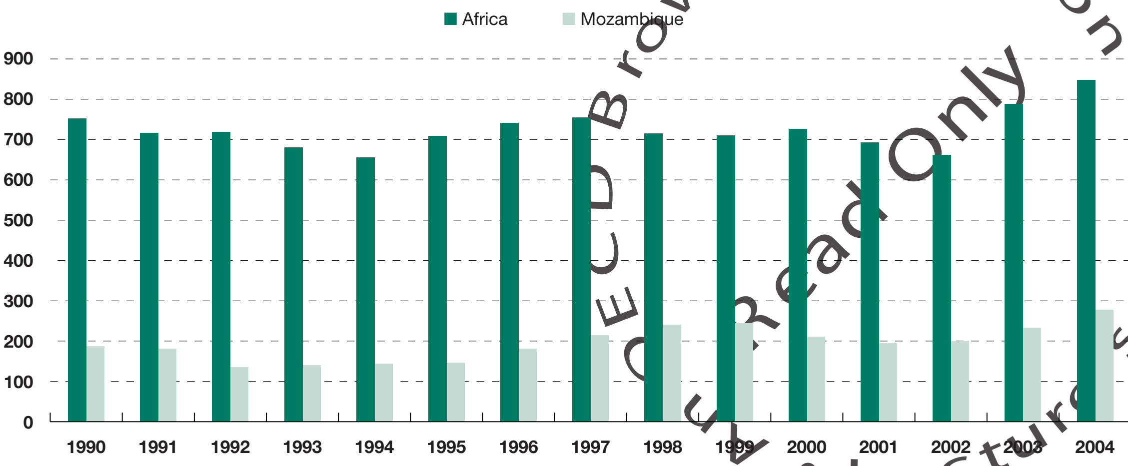
Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

growth pattern, as well as the ability to turn the mega projects, which have limited spillover effects on the rest of the economy and benefit from substantial tax holidays, into sources of new jobs and fiscal revenues.

In December 2004, President Joaquim Chissano, in power since 1986 and winner of the previous two multiparty elections, was replaced by Armando Emílio Guebuza, a senior member of Frelimo for about four decades and a veteran of the liberation struggle against Portuguese colonialism. Despite some protests from the opposition, independent national and international observers were broadly satisfied with the election's fairness.

Multiple challenges await the new authorities. They need to improve governance, including judicial modernisation, take a tougher stance on corruption, and implement co-ordinated and coherent structural reforms to improve resource allocation and create new capacities. Such measures are of the uttermost importance in order

Figure 2 - **GDP Per Capita in Mozambique and in Africa** (current $)



Source: IMF.

to widen the development and growth base of the economy, accelerate job creation, fight poverty, and comply with development partners' conditions.

Recent Economic Developments

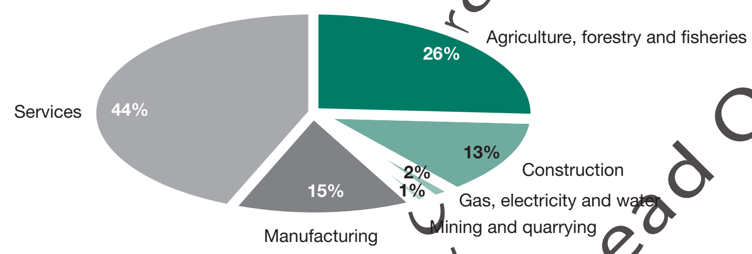
In 2003 and 2004, economic activity was mainly driven by the strong performance of the extractive and manufacturing industries, dominated by the two mega-projects. Good harvests for the main export crops and buoyant demand for transport and communication services also contributed to high growth.

While agriculture in Mozambique enjoys favourable soil conditions, it suffers from erratic rainfall patterns, particularly in the more arid south. In both 2003 and 2004, drought affected the country's south, while in the northern and central regions rainfall was abundant. Agriculture expanded by over 8 per cent in 2003 and 2004. On balance, production of both staples (beans, maize, and manioc) and cash crops (cashew nuts, cotton, sugar and tobacco) exceeded previous years' levels and, in many cases, reached all-time highs. Areas under cultivation increased markedly for most products and in all areas. In particular, the sugar and tobacco sectors experienced very fast growth, owing to respectively, the privatisation of many sugar plantations and preferential access to the European Union market, and the decline of production of tobacco in Zimbabwe. Productivity also rose on account of broader, albeit still far from sufficient, availability of fertilisers and high-yield varieties and, to a more limited extent, thanks to the Agricultural Sector Public Expenditure Program (PROAGRI II) in enhancing extension services.

The World Food Programme, in its Vulnerability Analysis report, indicates that food insecurity has declined significantly since the 2001-02 harvest season and that further improvements are likely to occur in the next harvest season. Agricultural production is expected to grow by 6.5 to 7 per cent annually from 2004 to 2007. Despite this overall progress, augmenting the sector's productivity calls for major efforts to improve access to credit, to stimulate the adoption of new technologies and to invest in rural infrastructure.

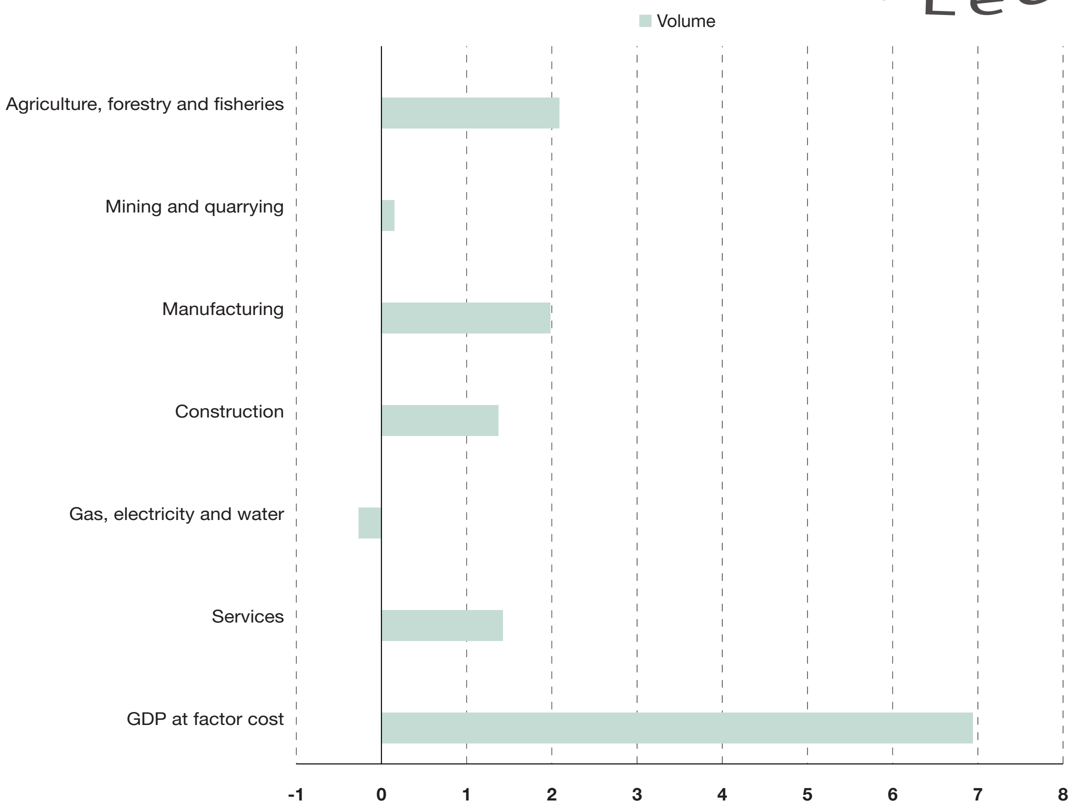
Over the past five years, the size of manufacturing in Mozambique has changed dramatically with the completion of a major aluminium smelter (Mozal) in Maputo province. With the expansion completed by end-2003 to an installed capacity of 512 000 tonnes, production grew by 82 per cent in the first half of 2004. Aluminium alone now accounts for about 50 per cent of total manufacturing output. Growth in other capital-intensive manufacturing branches, such as beverages and cement, was also strong, whereas agro-industries recorded a more muted performance. The crisis in the textile and clothing sector continued. Textile and

Figure 3 - GDP by Sector in 2003 (percentage)



Source: Authors' estimates based on National Institute of Statistics data.

Figure 4 - Sectoral Contribution to GDP Growth in 2003 (percentage)



Source: Authors' estimates based on National Institute of Statistics data.

clothing production has fallen from 20 per cent of manufacturing output, in the 1980s, to less than 3 per cent in 2003. Only two clothing factories are still in operation, and all of the four large textile plants are closed. The second mega-project concluded in 2004 is the pipeline to transport natural gas from Inhambane province to South Africa. The completion of the pipeline was followed by a surge of national gas production which grew by 130 per cent in the first half of 2004.

The construction sector, which is concentrated around the large projects, contracted by 10 per cent following the completion of the gas pipeline and of the Mozal extension programme. However, the sector is expected to rebound in 2005-06 with the start of a new $500 million titanium-bearing sands mine and smelter in Moma, the rehabilitation of the Ressano Garcia and Nacala Corridor railways, and of the Sena railway line from Tete to Beira.

In the service sector, transport and communications grew by 35 per cent in the first half of 2004, reflecting the expansion of existing port operations and increased air traffic, owing to the entry of a new private carrier, as well as the entry of a second mobile operator, Vodafone. Almost 80 per cent of investment in transport takes place around the three so-called corridors: Maputo to South Africa, Beira to Zimbabwe, and Nacala to Malawi. A concession to operate Maputo port was issued in 2003 and the $70 million investment in the first three years is expected to improve links between the Maputo corridor and the South African hinterland, in direct competition with the port of Durban.

Private investment remains on an upward trend, thanks notably to increased foreign investment in a few mega projects. After recording a steep rise in the early 2000s as a result of the exceptional reconstruction effort following the floods, public investment has levelled off. Government expenditures diminished in 2004 owing to a shortfall in external grant disbursements. External demand is estimated to have improved in 2004 on account of the rapid growth of aluminium exports and a fall in imports of capital equipment following the completion of Mozal II and

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Gross capital formation	**21.8**	**41.5**	**44.7**	**44.7**	**44.3**	**48.1**	**50.9**
Public	11.2	16.6	14.3	14.3	12.0	13.0	12.9
Private	10.6	24.9	30.4	30.4	32.3	35.1	38.1
Consumption	**101.8**	**72.9**	**68.0**	**68.0**	**63.1**	**60.2**	**59.1**
Public	8.0	13.9	14.3	14.3	13.8	13.6	13.4
Private	93.8	59.0	53.7	53.7	49.3	46.7	45.7
External sector	**-23.7**	**-14.4**	**-12.7**	**-12.7**	**-7.4**	**-8.4**	**-10.1**
Exports	12.2	29.2	33.0	33.0	35.1	34.1	31.5
Imports	-35.8	-43.6	-45.6	-45.6	-42.5	-42.5	-41.6

Source: IMF and National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

of the Sasol gas pipeline.

Macroeconomic Policies

Fiscal and Monetary Policy

The 2001-05 Poverty Reduction Strategy Paper (PARPA) presents the government's main economic policy objectives. Following an overall satisfactory evaluation of the implementation of the strategy over the past four years, in mid-2004 the government and the IMF agreed on a three-year Poverty Reduction Growth Facility. Notwithstanding the success of the government's efforts to consolidate macroeconomic stability, a series of weaknesses remain to be addressed, especially in terms of improving the efficiency of social spending and removing obstacles to private sector development.

Development partners have engaged in a dialogue with the Mozambican authorities on selected priority areas, including fiscal management, public sector and financial reforms, investment climate improvement, and the modernisation of justice. In 2003, in the context of the joint review of the government's programme, the PARPA goals were streamlined by developing a Performance Assessment Framework (PAF) matrix. The PAF provides a series of performance indicators to monitor progress in implementing the government's medium-term strategy, and to assist donors in making decisions about aid. Donors finance roughly half of the government expenditures.

The 2003 budget outcome was unsatisfactory, as the overall deficits (including bank restructuring costs) exceeded the official target of 3.9 per cent of GDP.

Table 2 - Public Finances (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**17.6**	**28.1**	**25.9**	**24.9**	**21.8**	**20.9**	**20.6**
Tax revenue	9.8	11.8	12.5	13.3	12.8	12.5	12.6
Grants	7.0	14.8	11.8	10.6	8.0	7.4	6.9
Total expenditure and net lending[a]	**20.7**	**34.7**	**33.8**	**29.8**	**27.0**	**27.9**	**27.5**
Current expenditure	9.4	14.7	15.6	16.3	15.5	14.8	14.7
Excluding Interest	*8.0*	*14.0*	*14.1*	*15.0*	*14.4*	*14.0*	*13.9*
Wages and salaries	2.2	7.0	7.3	7.5	7.3	7.2	7.1
Interest	1.4	0.7	1.5	1.3	1.1	0.8	0.8
Capital expenditure	11.2	16.6	14.3	13.0	10.9	11.9	11.8
Primary balance	**-1.6**	**-5.9**	**-6.4**	**-3.7**	**-4.1**	**-6.2**	**-6.2**
Overall balance	**-3.1**	**-6.6**	**-7.9**	**-4.9**	**-5.2**	**-7.0**	**-7.0**

a. Only major items are reported.
Source: IMF and Ministry of Finance and Planning data; estimates (e) and projections (p) based on authors' calculations.

Despite lower spending on goods and services, the 2004 overall deficit is estimated to have increased to 5.2 per cent of GDP from 4.9 per cent in 2003, reflecting significant grants and revenue shortfall. Delays by some companies in complying with payments under the new corporate income tax code, as well as the adverse impact of the appreciation of the *metical* on customs collections resulted in lower than programmed tax receipts. Only taxes on petroleum products performed well, as a result of the introduction of automatic adjustment[1] of fuel taxes on a quarterly basis in order to prevent the erosion of receipts by inflation.

In line with the PARPA prioritisation of public spending, the allocation of non-interest expenditures in priority sectors – education, health, agriculture, infrastructure, good governance and macroeconomic and financial management – increased from 55 per cent of total expenditures in 2003 to 63 per cent in the same period of 2004, slightly off the PARPA target of 66 per cent. Budget execution figures differed widely among sectors and provinces, with health and water exhibiting particularly low execution rates, leading to insufficient output, while others overspent. This reflects delays and unpredictability of donors' and line ministries' disbursements and irregularities in line ministries' planning and budgeting.

In order to improve efficiency and transparency in the use of public funds and allow for timely budget execution in key areas, priorities for 2005 include strengthening the monitoring and auditing of the budget process, as well as the state administration functions. Key measures include the adoption of a detailed system of classification by function, tighter controls on the wage bill and the introduction of an integrated budget, treasury management, accounting and internal control system. The government is also restructuring five major ministries. Moreover, districts have been recognised as budgetary units since 2003 and they can now access a donor-funded discretionary fund to finance small-scale infrastructure works on the basis of a participatory planning process. To provide clearer co-ordination mechanisms, align donors' programmes with government planning and implementation cycles, reduce the volatility of disbursement, and maximise the development impact of budget and balance-of-payment support, 15 donors signed a Memorandum of Understanding with national authorities in April 2004 that sets forth the details of direct budgetary support.

Budgetary spending is expected to increase over

1. In January 2004, the authorities issued a decree increasing the specific fuel taxes by an additional 2 per cent and adopting an automatic quarterly mechanism to prevent their erosion in real terms.

2005-06, but at a slower rate than in recent years. PARPA-related expenditures are expected to reach 67.3 per cent of total expenditures in 2005, and will be mainly channelled towards education and transport infrastructure and hospital revitalisation programmes. The budget also projects new hiring of teachers and health personnel. This increase in current and capital outlays will be only partially offset by increased tax revenues, stemming from further improvements in tax administration as well as from the expiration of tax benefits applied to some projects. Budget deficits are expected to average 7 per cent in 2005 and 2006.

In 2004, the monetary policy targets included a reduction in money supply growth to 15 per cent (from 19 per cent in 2003) and a year-end inflation of 11.4 per cent. The Central Bank is progressively shifting towards indirect market-based instruments, such as weekly auctions for overnight and short-term paper. Another measure has been the mid-2004 broadening of the legal basis for calculating reserve requirements to include non-resident and escrow deposits. Moreover, the central bank has increased the use of foreign exchange sales to sterilise the monetary impact of government spending, following large placements of domestic debt instruments in the first half of 2004.

Although Mozambique's oil imports are denominated in US dollars, most other imports come from South Africa and the Euro zone. The *metical* depreciated against the rand by about 30 per cent in 2003 and 13.5 per cent in the first half of 2004. With food items, including sizeable imports from South Africa, accounting for more than two thirds of the CPI basket, the depreciation passed through to prices. Average CPI inflation in 2003 reached 13.4 per cent, in excess of the government target of 10.8 per cent.

Nevertheless, since May 2004, the local currency has been continuously strengthening in nominal terms against the US dollar and the South African rand. The appreciation *vis-à-vis* the US dollar, at about 18 per cent in 2004, reflects delays in donors' disbursements, which were heavily concentrated in the last four months of the year. The strengthening against the rand shadows the South African currency's depreciation following the interest-rate cut by South Africa's monetary authorities in August 2004. In turn, the strength of the currency impacted positively on inflation. Average annual inflation declined to 12.4 per cent in 2004, and ended the year at 9.1 per cent, below the target, following a slower rise in food prices that offset increases in oil prices. Against a background of a favourable 2005 harvest as well as expectations that the currency will retain some of its recent strength, inflation is projected to average 9.1 and 7.1 per cent in 2005 and 2006, respectively.

External Position

Mozambique participates in various regional preferential trade initiatives. As part of the South African Development Community (SADC) Trade Protocol, the country is committed to gradually lowering its tariffs with SADC member countries until achieving free trade. Implementation of tariff reduction will start in 2008 and free trade will be reached in 2012 with all countries except South Africa (complete elimination of tariffs is due in 2015).

Trade relations with the EU received a strong boost by the signing of the sugar protocol – that allows quota-free exports as well as uptake of unused quotas by other ACP countries. Finally, since 2003 AGOA eligibility has provided Mozambique preferential access to the US market for selected products, notably apparel. However, weak production facilities, particularly in manufacturing, have prevented firms from taking full advantage of such provisions. Indeed, Mozambique would benefit from an Economic Partnership Agreement (EPA) with the EU only with a strong development component that supports the development of institutional and productive capacities.

Mega-projects strongly shape the trade balance. In 2003, aluminium exports – which account for more than 50 per cent of Mozambique's total exports of goods – rose by 40 per cent, raising total exports to $880 million from less than $700 million in 2002. Mozambique which did not even produce any aluminium until 2000, is now the third largest exporter of aluminium to the EU.

Other products recording strong growth include sugar, timber and cotton, while prawns continued on a downhill trend. With Mozal II now completed and Sasol gas exports making their debut, preliminary estimates for 2004 point to a 60 per cent increase in exports from large projects.

South Africa's share of Mozambique's exports has risen to 18 per cent, although Belgium remains the largest market – a somewhat misleading statistic in view of the fact that aluminium is traded through an Antwerp-based trading company. South Africa also remains by far the single largest source of Mozambique's imports, at roughly 40 per cent. Food products are almost exclusively sourced from South Africa and electricity, equipment and machinery are also mainly imported from its powerful neighbour.

The trade deficit fell from 13 per cent of GDP in 2003 to an estimated 6.4 per cent in 2004, despite increased oil and electricity imports. Over the 2005-06 period, the expected increase in imports of capital goods, as a result of the construction of the Moma titanium smelter and the planned expansion of the gas pipeline will be partially offset by buoyant aluminium exports and the first full year of gas exports.

With the natural gas and titanium-bearing sand mine coming on stream, it is estimated that by the beginning of 2006, three products alone will account for roughly 80 per cent of exports. Although net exports are expected to increase substantially, concerns exist regarding the vulnerability to the vagaries of world raw commodity markets, as well as the ability to turn the mega projects, that benefit from substantial tax holidays and other incentives, into sources of new jobs and fiscal revenues.

Table 3 - **Current Account**[a] (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-19.6	-10.5	-18.7	-13.1	-6.4	-5.8	-6.9
Exports of goods (f.o.b.)	8.0	20.5	18.9	20.4	25.0	25.7	23.8
Imports of goods (f.o.b.)	-27.5	-31.0	-37.5	-33.5	-31.4	-31.4	-30.7
Services	-3.2	-17.6	-5.7	-5.5			
Factor income[a]	...	...	...	...			
Current transfers[a]	7.9	13.7	11.7	12.4			
Current account balance	**-14.9**	**-14.5**	**-12.7**	**-6.2**			

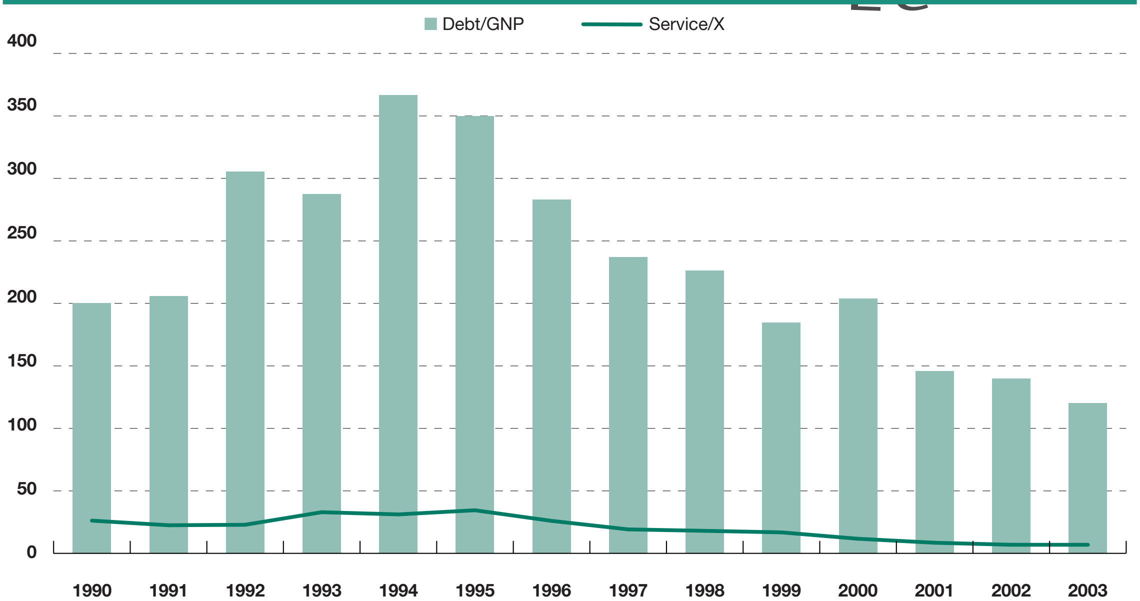
a. Factor income is included in services.
Source: IMF and Bank of Mozambique data; estimates (e) and projections (p) based on authors' calculations.

Two related phenomena – the mega-projects, which account for more than 90 per cent of cumulative FDI flows over the 1998-2004 period, and the interest of South African business in the Mozambican economy – have driven FDI activity over the past few years. Since 1985, the investment promotion centre has registered more than 262 South African projects by 182 companies and their accumulated investment value had reached $1.33 billion by end-2003 – making Mozambique the main regional location for South African FDI. In export-oriented sectors, South African investors (including companies that, while originally South African, now have their primary listing overseas) have been attracted by abundant natural resources, including gas reserves, low labour costs and subsidised electricity tariffs, as well as by extensive government incentives. BHP-Billiton has invested $2.2 billion in Mozal, while synthetic fuels group Sasol is the lead investor in the Pandé-Temane gasfield project, having put in more than $1 billion. State-owned Spoornet is rehabilitating the Ressano Garcia railway. As part of their regional expansion strategy, South African investors also control three of the four sugar estates, large cereal mills, all breweries and soft-drink bottling plants and most tourism facilities, especially outside of Maputo. A substantial number of smaller firms are also involved.

Despite their positive contribution to the country's GDP and exports, which almost tripled over the past five years, the mega-projects source most of their inputs from South Africa and risk crowding out domestic firms. The capital-intensive and knowledge-specific nature of much FDI limits the scope for linking up with local business. Although backward and forward linkages have started to increase – the International Finance Corporation launched a programme which successfully linked 12 Mozambican companies to $3 million worth contracts with Mozal – the integration between domestic and foreign business remains very limited.

In 2001, Mozambique became the third country (after Bolivia and Uganda) to reach the HIPC completion point for debt relief. Most Paris Club members have already given, or are soon expected to provide, debt relief, and a commercial debt buyback scheme is now operational. As a result, the external debt burden has stabilised at a sustainable level, with the net present value of debt-to-GDP forecast to decline gradually to 20 per cent by 2006. The government has undertaken measures to improve debt management. Dramatic progress in reducing the foreign debt to GDP ratio (although still very high relative to peers such as Ghana

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

and Cameroon), as well as sustained high output and exports growth, have improved creditworthiness, leading Fitch to upgrade Mozambique to the B rating category.

Structural Issues

Although in the 1990s Mozambique carried out one of Africa's farthest-reaching privatisation programmes, results have been mixed and the expected additional contribution to investment, domestic product and employment creation have not materialised. During the process, many small and medium enterprises, which constituted the bulk of State Owned Enterprises (SOEs) acquired by Mozambican nationals encountered serious financial difficulties and went bankrupt. On the other hand, medium to large-sized enterprises bought by foreigners in sectors such as cement, beer, tobacco, and sugar were more successful, increasing sales and production levels.

By mid-2002, 20 large and 200 small SOEs remained to be privatised, mostly in the transport and communications sector. In recent years, no major privatisations have been concluded and little progress is in sight. Admittedly, in sectors such as energy, the global record of privatisation has been mixed. However, very little is known about employment levels, asset values, and financial and operational performance for most state-owned enterprises. In theory, the creation of a dedicated agency in early 2002 to manage state participations and prepare state-owned enterprises for divestiture was a major institutional breakthrough. In practice, IGEPE (Institute for the Management of State Shares) does not have any implementing autonomy. The government has so far failed to agree on a clear strategy regarding the choice of strategic sectors to be kept under state ownership and the long-term objectives of privatisation. While selected enterprises have been commercialised, others – including the ports and railway company, Companhia de Portos e Caminhos de Ferro de Moçambique (CFM), the post office, the airports, and Electricidade de Moçambique – are still subject to ministerial oversight. A consortium of CFM and Cornelder-Mozambique of the Netherlands, which is already co-managing the Beira container terminal, has been awarded the contract to run the port of Quelimane.

Some limited progress has been achieved in liberalisation of public services. In cellular telecommunications, in August 2002 a second GSM licence was granted to Vodacom International in association with local partners (Emotel, a consortium of local businesspeople, and the war veterans association). Vodacom Moçambique's services launch, however, was delayed by a year. When operations finally began in late 2003, Vodacom only covered limited portions of the country, and the price of pre-paid cards has basically remained unchanged despite the theoretically more competitive conditions. The repeal of the decree that granted state-owned LAM a monopoly on domestic routes allowed a new private airline, Air Corridor, to start operation, offering better services and cheaper non-peak fares. Additionally, although the Sasol pipeline is meant to be an open-access, government-regulated service provider, there is still some apprehension regarding Sasol's control of both the pipeline and the South African gas market, where it has an effective monopoly.

Donors are attaching increasing importance to governance issues in the broader sense and are ready to impose greater conditionality in the disbursement of budgetary support. The media, civil society, and business associations, although still in their infancy, are also increasingly vocal. Nonetheless, very little progress, if any, has been made in 2003-04 in legal and financial modernisation, in judicial reforms, and in fighting corruption. Lukewarm political will, coupled with limited budget and human resources, pose major challenges. The commercial, civil procedure, and procurement codes, areas in which revisions appear key, are far from ready for parliamentary discussion. Although Parliament recently passed a law for tribunal courts and the Council of Ministers approved the strategic plan for the sector, implementation of key elements, such as the appointment of new judges and prosecutors, the execution of budget approvals, and access to public defence remain weak. Finally, a more determined drive to fight high-level corruption is hampered by the standstill over the anti-corruption bill. This was passed by Parliament in late 2003, but certain articles were seen as breaching the Constitution and the law has not been ratified yet. An anti-corruption unit exists in the Attorney's General office, but it lacks autonomy and financial resources.

Mixed results from regulatory reform and limited progress in addressing the vulnerability of the financial system underline a general perception that the business environment in Mozambique is poor and does not provide the right incentives for investors to engage in risk-taking and job-creating activities. Investment climate surveys identify a series of constraints to private sector activity: inefficient bureaucracy leading to delays in company registration procedures, a weak legal system that jeopardises the enforcement of contracts, and widespread corruption. Labour regulation is rigid, constraining for instance the employment of expatriates, and the judicial backlog is long. Partly because the size of the economy is small, partly because no competition policy exists yet, abuses of market power and collusive behaviour add to the cost of doing business in Mozambique. Strikingly, political risk or political instability are seldom cited as problems – a substantial advance for a country that a decade ago was beset by a civil war.

Undoubtedly, these constraints affect Mozambican business differently, depending on the size and

Donors' Credit Lines Based on Risk Sharing and Punctual Monitoring System

Several donors have directly supported the re-establishment of the economic base of small and medium Mozambican entrepreneurs which had been severely damaged by the floods that hit the country in 2000. A particular scheme is the one carried out by USAID. Under such a scheme the *metical* equivalent of $22 million has been channelled through the local banking system to flood-affected enterprises. A **Program Committee,** composed by representatives of USAID and of the Government of Mozambique, was established in order to allocate the funds provided by USAID. A local firm was contracted by the Program Committee to set up a **Project Management Unit (PMU)** to manage the loan fund. **PMU** was in charge of co-ordinating and executing the loan scheme and drafting an agreement with local banks in order to establish rules and procedures to manage the loans. The loan scheme has been carried out according to the following criteria:

- Loans to affected enterprises are provided at below market interest rates (8-10 per cent compared with the outside commercial rates of 34-36 per cent). Principals and interests are paid quarterly.
- The commercial risk is shared 50:50 between USAID and the banks.
- Beneficiaries of these loans are able to make repayments for up to five years with up to one year's grace period.
- The ceiling for the loans was originally established at $100 000 and successively increased to $250 000.
- The Program Committee has to pay the banks a commission fee of 2 per cent over the value of each credit disbursed and already reimbursed.

The banks are required to report monthly to the PMU about:

- The volume of credit disbursed.
- Amount of reimbursements received.

On the basis of these monthly reports, PMU carries out the auditing and monitoring activities of the credit operations.

The total number of loans extended with this programme was 274, with the largest loan amounting to $250 000 and the smallest $1 471. Thanks to a system of punctual monitoring carried out by PMU, loan repayments are on track. This typology of Guarantee funds has been replicated by other donor agencies and proved to be successful.

It should be noted, however, that in other similar schemes, some banks tend to take advantage of the guarantee funds and the risk-sharing agreement without reducing, for instance, the interest rate or the percentage of collateral required from their clients. In response to this concern and in order to increase competition between the local financial institutions, new procedures are under development. Risk-sharing will be made available to the local financial institutions that offer the best credit conditions to the final beneficiaries of the guarantee fund. The intention would be to share risk but also to push the financial institutions to soften their credit conditions (i.e. percentage of collateral, interest rates, repayment time).

characteristics of the companies. Large foreign businesses are generally positive about the investment climate as they are granted preferential treatment by the government and are more insulated from the domestic economy. For instance, in order to speed up imports of inputs needed for the Pande-Temane pipeline, Sasol was allowed to establish its own customs terminal. Additionally, large foreign companies have access to finance, technology and markets through the companies they are affiliated to.

All these obstacles, on the other hand, have a very prominent impact on the indigenous formal private sector, which comprises 27 800 enterprises with a total turnover of 60 billion *meticais*, and which provides employment to 274 000 people. Moreover, a substantial share of economic activity is undertaken in the informal sector, mainly in trade or trade-related activities, although no reliable estimate exists of its weight. The majority of these firms are micro-enterprises employing ten or fewer staff concentrated in the Maputo area. Small firms are extremely weak and lag behind regional competitors in terms of modern management and manufacturing techniques and practises, offsetting the advantage of an abundant supply of low-cost labour.

More than 80 per cent of companies consider high costs of bank borrowing to be their major problem, while 75 per cent say that access to domestic and foreign credit is too limited. The large majority of Mozambican firms rely therefore on their own resources to meet investment and working capital needs. The agricultural and agro-industry sector has the least access to formal financial institutions. Overall, only 16 per cent of credit goes to agriculture – and mainly to large foreign-owned farms – while 35 per cent goes to industry and 49 per cent to trade and other services. However, the weight of credit to agriculture is expected to increase as a result of the new strategy of South African banks (Standard Bank and ABSA) to support medium and large commercial farmers, mainly Zimbabwean, in Manica.

A wide range of initiatives by government agencies, private sector associations and donor organisations have sought to promote SMEs financing. These schemes typically involve provision of concessional loans in tandem with technical, advisory and marketing services to SMEs. While governments' special funds for SMEs and support services have been implemented on a very small scale with little impact, some donor-funded initiatives proved to be more successful. Small, private and parastatal institutions operating on a much smaller scale include GAPI (Gabinete de Promoção para Pequena Industria), FFPI (Fundo de Fomento á Pequena Industria), and FCC (Fundo Comunitario de Credito) that support smallholder associations mainly in the agribusiness sector. However, they strongly depend on donors' funds, have limited outreach, and lack internal capacity and financial resources. In general, there is very limited information about other financial services, such as microfinance institutions, which are mainly concentrated in individual lending in urban areas, with loan amounts not exceeding $2 000.

Overall, support to SME financing appears fragmented. The lack of a coherent industrialisation strategy hinders co-ordination and impedes prioritisation. This reflects the lack of national private sector development policy and limited dialogue between authorities, donors and the private sector.

Political and Social Context

On 3-4 December 2004, the third consecutive multiparty presidential and parliamentary elections took place, a considerable achievement in a country that lived, after independence, through a 16-year long war until 1992. Participation was very low, as only about 36 per cent of people voted. Independent national and international observers alike viewed the election as mostly fair, despite detecting some irregularities. Armando Emílio Guebuza, the candidate of the Frelimo ruling party, had a 32-percentage points lead over the main opposition candidate. Frelimo had almost 33 percentage points of advantage over the main opposition party. Only two parties, Frelimo and the coalition Renamo-União Eleitoral achieved the 5 per cent barrier and had members of parliament elected (Renamo with a much reduced number of MPs). The election results demystified the idea that the country is politically divided along geographical lines, as Frelimo, apart from maintaining its strong hold in the South, won in all but two regions (Sofala and Zambézia).

President Guebuza has placed the fight against poverty, corruption and crime at the centre of his political manifesto. In his inaugural speech, on the 2 February 2005, he emphasised the need for co-ordinated policies and actions against corruption and collective responsibility in the council of ministers and the government as a whole. The new cabinet includes 26 ministers (including the prime minister) and 15 deputy ministers. Of these, eleven are women (seven ministers, including the prime minister and four deputy ministers). Only 13 members of the previous Cabinet (of 42) remain in place, including the Prime Minister, Luisa Diogo, while all the previous ten provincial governors have been appointed ministers or deputy ministers.

Prior to the December general elections, the Parliament elected in 1999 met in its last session to approve the new Constitution of the Republic, which introduces several important innovations. It reinforces the area of justice and legality, creates the State Council in which the leader of the second most voted Party has a seat, and makes other minor changes to the previous text. The new Constitution was approved by unanimity.

According to a recent household survey (Inquéritos aos Agregados Familiares 2002/03), the proportion of poor in Mozambique significantly declined from 70 per cent in 1996/97 to 54 per cent in 2002/03. However, this positive achievement masks significant regional variations. Incidence seems to have fallen dramatically in the centre, especially in the Tete and Sofala provinces, where poverty has fallen from above 80 per cent to 60 per cent and 36 per cent respectively. However, the poverty rate in the Southern province of Inhambane continues to exceed 80 per cent. Another recent survey carried out by the Ministry of Agriculture, which is based on income instead on expenditure, suggests a reduction of poverty by 4 per cent only.

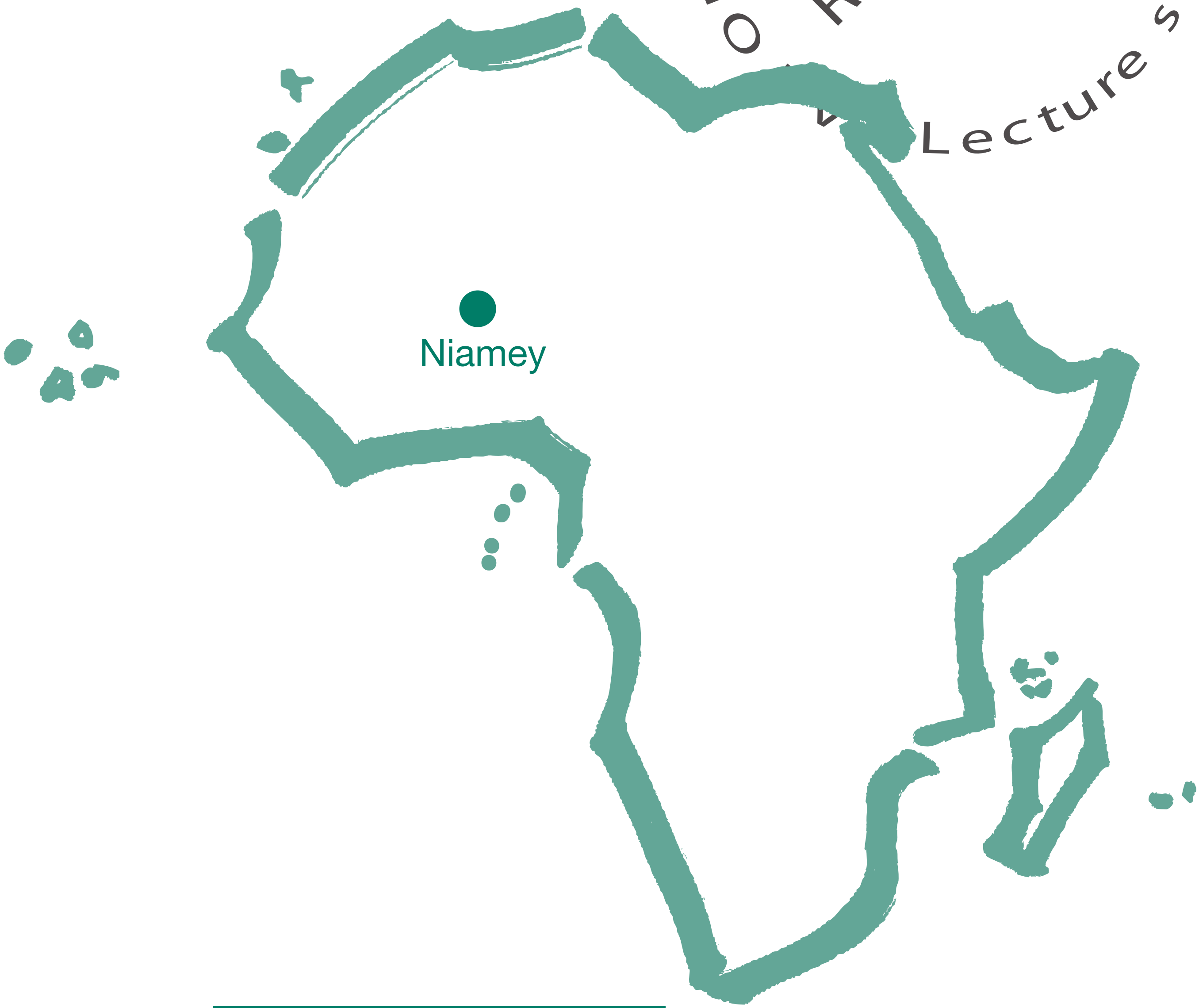
Based on the IAF results, the authorities put Mozambique on track to achieve the PARPA goal of reducing the poverty rate to 50 per cent by 2010 and reach the first Millennium Development Goal (MDG) by 2015. Nonetheless, it is very unlikely that the country will achieve the other MDGs on gender equality, access to safe water in urban areas, maternal mortality and malaria. This reveals that despite the drop in poverty, income per capita, human capital and other human development indicators are still amongst the lowest in the world: Mozambique is ranked 171 out of 177 countries in the UN 2004 Human Development Index (HDI).

The PARPA evaluation highlighted progress in rehabilitating infrastructure, training health professionals and providing equipment to health centres. This translated into a reduction in infant mortality rates from 149 per thousand births in 1995 to 101 per thousand births in 2003. Other major improvements were recorded in child vaccination rates and in the percentage of attended births from 38 per cent in 1999 to 46 per cent in 2003. Despite these improvements, the health sector suffers from a series of weaknesses, including the lack of a comprehensive strategy in the area of maternal and paediatric care, low budget execution rates due to delays in disbursement from the government and donors and uneven access to health services between provinces. The PARPA objective of providing 80 per cent of households in two provinces with mosquito nets is far from being achieved. Moreover the salary and incentive policy does not promote productivity and/or motivate health professionals to work in remote areas. The capacity of health care workers is very low and the doctor/population rate is amongst the lowest in the world and is falling further.

HIV/AIDS remains one of the greatest threats to the development of the country, with life expectancy consequently falling from 47.1 years in 1997 to 37.9 years in 2004. The infection rate was 15 per cent of the population in 2004 and is increasing rapidly. Efforts in the last two years have concentrated on the creation of a policy and institutional framework for the implementation of the 2001-03 National Strategic Plan (NSP). A National Aids Council (NAC) was also established to ensure a multisectoral approach and greater partnership with civil society and other stakeholders. However, government's action to fight HIV/AIDS faces institutional and strategic difficulties. Evaluations of the NSP reveal significant problems of human and institutional capacity of the NAC to lead the national response effectively and absorb the resources allocated. Access to prevention, care and treatment is still very limited. Despite recent commitments by Brazil to build a factory in Mozambique to produce cheap generic anti-retroviral drugs, the cost of these drugs remains too expensive to be distributed in adequate quantities. Stigma hinders many actions and the awareness campaign is insufficient. The revised NSP, under preparation, will try to address these shortcomings, adopting a multisectoral approach to improve service delivery systems and financial management. More resources are currently being made available by the donors community, especially to provide anti-retrovirals and reduce mother-to-child transmission.

Although threatened by HIV/AIDS, Mozambique has made progress in education since the inception of PARPA. The gross enrolment for boys in lower primary education (EP1, the first five grades) has been over 100 per cent since 2001, and gross EP1 enrolment for girls has increased from 43 per cent in 2000 to 46 per cent in 2003, exceeding PARPA targets by wide margins. Accounting for more than 5 per cent of GDP, spending on education has led to substantial progress in teacher training and school construction. However such improvements have been uneven among provinces and the execution rate of investment is still low. Lack of monitoring and evaluation of external funds has also posed major problems in mid-2004, as misuse of the funds led the Ministry of Education to reimburse the donor. Moreover, repetition and dropout rates remain high (at about 22 per cent and 8 per cent, respectively, in lower primary education) and the supply of skilled teachers is low, owing partly to the impact of HIV/AIDS. A new strategic plan for education 2005-09 is under preparation and will focus on improving financial resource management and increasing the completion rate in primary education through the introduction of

Niger



key figures

• Land area, thousands of km²	1 267
• Population, thousands (2004)	12 415
• GDP per capita, $ (2003)	228
• Life expectancy (2000-2005)	46.2
• Illiteracy rate (2004)	81.8

NIGER IS NOT WELL ENDOWED by nature. Landlocked and dry, the country has one of the lowest levels of per capita income in the world and it ranked second to last of the 175 countries surveyed in the 2003 United Nations human development index. In spite of this, Niger recently registered noteworthy economic performances, demonstrating the importance of political stability and rigorous policies even in such a difficult environment.

The Nigerien economy relies principally on agriculture, livestock and uranium extraction. Its competitivity, strengthened by the devaluation of the CFA franc in January 1994, resulted in growth averaging 3.5 per cent per annum throughout the second half of the 1990s. The April 1999 coup d'état – which led to a drastic reduction in foreign aid and high political instability – dealt a severe blow to the economy. This instability ended and normality returned with democratic presidential elections and the formation of a new government at the beginning of January 2000, as well as with considerable efforts to cement the national peace. While GDP increased significantly (+5.3 per cent) in 2003, it seems to have slowed enormously in 2004 (to 0.9 per cent) as a combined result of the political instability in the neighbouring Côte d'Ivoire, drought and locust invasions.

Drought and locust invasions damaged growth in 2004 underlining the vulnerability of the economy.

With its budget 60 per cent financed by international aid, the Nigerien government introduced policies that benefited from the Heavily Indebted Poor

Figure 1 - **Real GDP Growth**

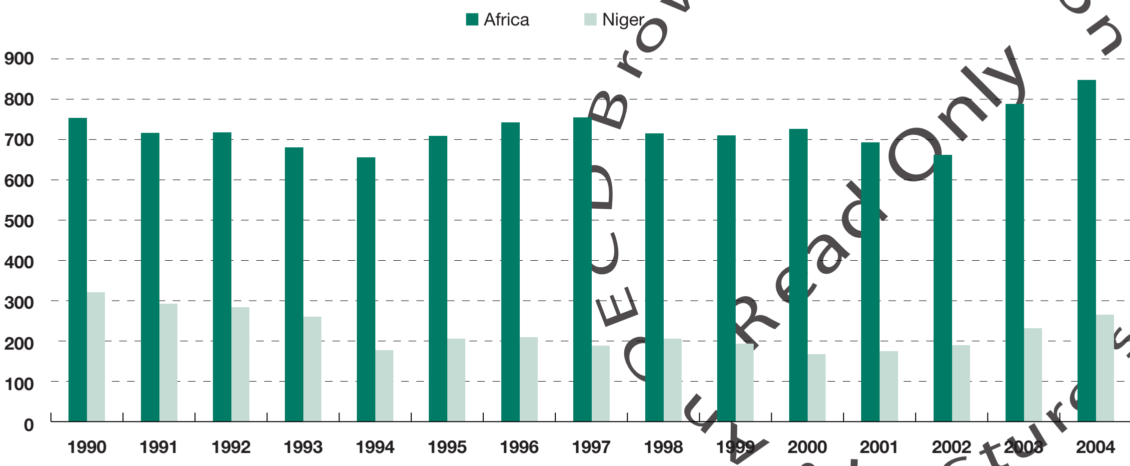
Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Countries (HIPC) Initiative, as well as growth and poverty reduction programmes. Thus, it is now in a position to pay salary arrears and to finance new investments in rural zones. In December 2004, President Tandja and his supporters won the presidential and legislative elections. They announced their intention to continue with and reinforce economic reforms in 2005 and 2006.

Recent Economic Developments

On the whole, Niger's economic performance was satisfactory in 2002/03, despite the negative effects of the crisis in Côte d'Ivoire and strong fluctuations in harvests, which highlighted the country's complete dependence on rainfall. Real GDP growth was 5.3 per cent in 2003, compared to 3 per cent in 2002, though

Figure 2 - **GDP Per Capita in Niger and in Africa** (current $)



Source : IMF.

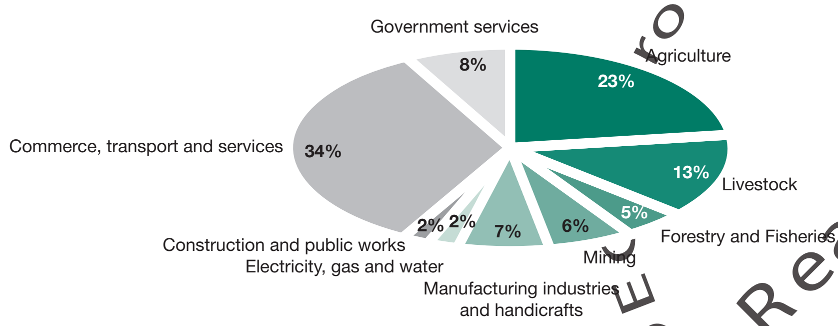
a downturn is expected in 2004. Largely due to drought and locust invasions, real GDP is likely to reach only 0.9 per cent in 2004. For the next three years (2005-07), the country has fixed a growth objective for itself of around 4 per cent subject to a sufficient rainfall and control of locust invasions. Expected improvements in irrigation should enable the creation of a cotton industry. Beyond this, the Nigerien government intends to support private sector growth.

The primary sector accounts for 41 per cent of GDP and for 60 per cent of exports. Dominated by agriculture and livestock, the sector is the main source of growth in the country. Agriculture is heavily dependent on climatic conditions (water management remains a chief issue). Thus, the good rainfall of the 2002/03 season enabled agriculture to grow to 8.6 per cent of GDP. Very good food production since this period has also contributed to lowering the Consumer Price Index (CPI), from an average of 2.7 per cent in 2002 to -1.7 per cent in 2003. This is primarily due to a fall in the price of food (by 4.9 per cent), particularly cereals. The 7 per cent increase in cereal production made it possible to rebuild strategic food reserves. Millet, the most drought-resistant grain, accounts for almost two-thirds of agricultural production. Rice production, mostly originating along the banks of the Niger River, remains inadequate for the population's needs, which are estimated at 200 000 tonnes. Nor is the sector competitive against Chinese imports.

In 2003, cottonseed production dropped by almost half. The national cotton company (*Société nigérienne de cotton*, SNC) has been unable to lend impetus to the industry's development unlike in other West African Economic and Monetary Union (WAEMU) countries. Cowpea – a rain-fed cash crop rarely consumed locally – is often informally exported to sub-regional markets (Benin and Nigeria), and is the sole agricultural product of real significance. For several years, and under the auspices of a project to promote agricultural exports (PPEAP), Niger has been attempting to develop the production of onions, gum arabic, turmeric, sesame, livestock, meat and leather and hides.

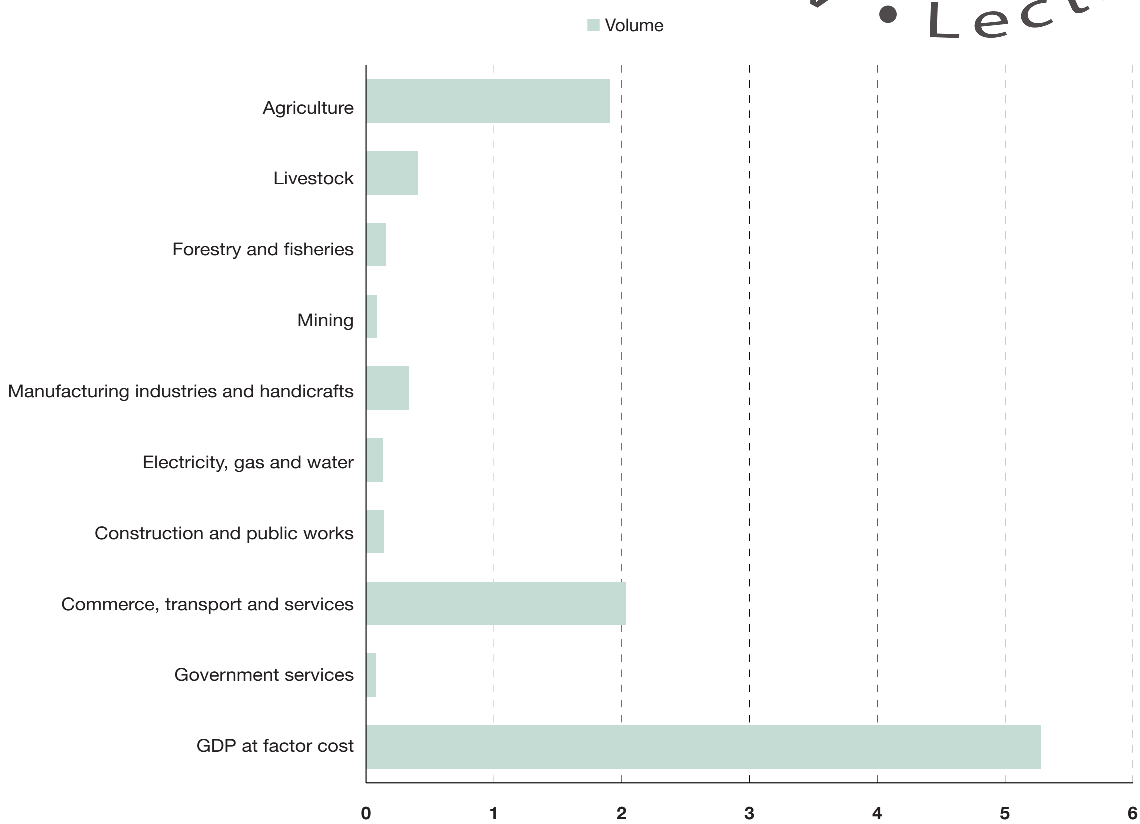
The good results of the agricultural sector in 2002/03 should not mask significant risk factors. Niger is particularly vulnerable to locust invasions. In August and September 2003, the first signs of locust numbers increasing became evident. These increased over the first semester of 2004, with locusts breeding all along the east side of Aïr (Tafidet, Ibel and Tchibossène). At the end of May 2004, the government acknowledged large-scale breeding in the Aïr Mountains. Monitoring and combating activities, begun in March and April 2004, had to be suspended in May following the exhaustion of insecticide supplies. With the rains of the second half of May 2004, new signs of an outbreak were noted that necessitated treatment. In a June 2004 report, the UN Food and Agriculture Organization (FAO) described the situation as "extremely alarming". The report forecast

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on IMF data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on IMF data.

very rapid increase in the number of locusts in the Sahel, swarms of insects bypassing the spraying in the African northwest and migrating to areas of recent rainfall. The FAO requested that Niger and other sub-Saharan African countries (including Mali and Senegal) undertake extensive detection and control operations. Unless they are able to mobilise the necessary funds, the entire region runs the risk of massive invasion, which will be particularly detrimental to farmers. The last locust invasion in Niger in 1987/89, cost the country more than 300 million dollars and took several years to bring to a close.

Husbandry (livestock, leather and hides) accounted for 13.3 per cent of GDP in 2003, making it the second largest export after uranium. The cattle herd increased

2 per cent in 2002/03 to over 3.6 million head, while the sheep and goat population grew respectively, by 3 and 2.5 per cent (for a total of 16.5 million head). Niger also possesses camel, horse and donkey herds. Despite the importance of livestock to the Nigerien economy and culture, derivative products such as milk, meat, leather and hides are poorly developed. Niger mostly exports livestock, notably to the high-potential and easily accessed Nigerian market. This industry is primarily informal and its development is hampered by the inadequacy of road, transport and slaughtering infrastructures. With the liquidation of the national leather and hide company (*Société nigérienne des cuirs et peaux*), the formal industry more or less disappeared. Formal activity is now limited to a few traditional tanneries with reputations for quality.

For the 2005/07 period, the government is aiming to improve agricultural production through water management and crop diversification. The authorities have forecast an increase in cash crops of 6.7 per cent (reference scenario), as well as an increase in public spending on agriculture of around 49 per cent in 2005. These funds will be directed at supporting irrigated and cash crops.

The secondary sector depends mainly on mining, dominated by uranium extraction as well as several non-representative small industries. Niger is the third largest producer of uranium in the world, behind Canada and Australia. COMINAK (*Compagnie minière d'Akouta*) and SOMAIR (*Société minière de l'Aïr*) are the largest extraction companies. Almost all of the uranium produced is exported to France (64 per cent) and Japan (29 per cent). In 2003, uranium accounted for 61.6 per cent of exports, up from 57.3 per cent in 2002. Uranium production increased by 5 per cent in 2003, to reach 3 143 tons, and two-thirds of this was produced by COMINAK. Uranium has been at the heart of Niger's development since the 1970s and 1980s, though the price of uranate per kilogram has been falling gradually for several years (from 21 100 CFA francs – 30.4 dollars – in 2002 to 21 090 CFA francs – 36.3 dollars – in 2003).

Gold mining is the second largest activity in the sector, and is led by the *Société minière de Liptako* (SML). The sector's contribution to the economy remains modest however, estimated at just 0.6 per cent of GDP during 2005/09. In spite of having a developed regulatory framework and significant geological assets – the country has reserves of coal (50 million tons), phosphate (1.2 million tons) and salt (25 million tons) – the country's landlocked position and poor infrastructure make it difficult to attract investors.

The near absence of an industrial sector (outside of public services) means that a large part of the population's needs are met by imports. In 2001, there were 58 production units in the manufacturing sector (46 actually operating), of which 15 were food-processing units, eight metal and wood construction and printing/publishing, and seven were in chemicals. In

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**9.7**	**12.1**	**14.2**	**14.2**	**15.4**	**16.2**	**16.9**
Public	4.6	7.1	8.8	8.3	9.1	9.6	10.2
Private	5.0	5.0	5.4	5.9	6.2	6.5	6.7
Consumption	**97.6**	**95.6**	**94.7**	**95.0**	**94.1**	**93.7**	**93.0**
Public	11.5	12.4	12.2	11.3	11.7	11.9	11.7
Private	86.2	83.2	82.5	83.7	82.4	81.8	81.3
External sector	**-7.3**	**-7.7**	**-8.9**	**-9.2**	**-9.5**	**-9.8**	**-9.9**
Exports	18.5	16.9	15.2	16.0	16.0	15.7	15.5
Imports	-25.8	-24.6	-24.1	-25.2	-25.5	-25.5	-25.4

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

2003, the manufacturing and craft industries accounted for 6.7 per cent of GDP.

The tertiary sector remains the principal contributor to GDP. Largely informal (three-quarters of tertiary GDP is from non-formal activities), this sector is characterised by a concentration on business and services. The sector has increased on average by 4 per cent per annum over the past seven years, driven by cross-border trade in spite of the 1999 political crisis.

Household consumption accounts for a large part of Niger's demand, representing over 80 per cent of GDP. The country's demand structure also attests to the weakness of overall investment despite increased public spending and the structural nature of the external deficit.

Macroeconomic Policies

Fiscal and Monetary Policy

The fiscal policy initiatives implemented by the Nigerien government – in collaboration with the IMF – were satisfactory. These consisted of continuing to strengthen budgetary policy through better control and allocation of current expenditure to bring spending into line with available budgetary resources. Current expenditure was strictly controlled and certain non-priority spending was postponed. This reduced current expenditure from 10.7 per cent of GDP in 2002, to 10.1 per cent in 2003, and it should reach 9.9 per cent in 2004. The wage bill remained stable from 2002-04 (at around 3.6 per cent). Thus, despite the local, legislative and presidential elections, current expenditure has not grown. The scheduled 3.5 per cent increase in public sector wages remains in line with GDP growth. The modernisation of public spending channels, both in terms of procedures and management systems, has resulted in the rationalisation of the management of public expenses.

State revenues have developed unevenly, with income falling from 15.6 per cent of GDP (including grants) in 2002 to 14.7 per cent in 2003, before climbing once again to 15.6 per cent in 2004. To increase its revenues, the government introduced a number of new measures in 2004. These included a tax on imported rice destined for re-export, a 12 per cent excise tax on tea and VAT on oils and edible fats. The effect of these measures should be felt during 2006. The HIPC Initiative income – from debt relief from bilateral and international creditors – was allocated in priority to basic education, secondary education and health. HIPC Initiative funds do not represent additional financial resources. The crisis in Côte d'Ivoire had a limited indirect impact on public revenues in 2003, as a reduction in imports from the country particularly affected customs income. More generally, the crisis has disrupted the major trade channels, leading to shortages of some consumer goods and essential primary materials. Onion and livestock exports to Côte d'Ivoire also dropped. The suspension of Côte d'Ivoire's payments under the WAEMU

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**12.7**	**13.5**	**15.6**	**14.7**	**15.2**	**14.2**	**14.9**
Tax revenue	6.7	8.9	10.0	9.0	9.4	10.0	9.9
Grants	4.9	4.2	4.9	4.8	4.9	3.3	4.1
Total expenditure and net lending[a]	**13.1**	**17.2**	**18.4**	**17.4**	**18.0**	**18.4**	**18.7**
Current expenditure	9.3	11.0	10.7	10.1	9.9	9.9	9.8
Excluding Interest	*7.6*	*9.3*	*9.2*	*9.0*	*9.3*	*9.3*	*9.2*
Wages and salaries a	3.3	3.5	3.7	3.6	3.7	3.6	3.7
Interest	1.7	1.8	1.5	1.1	0.6	0.6	0.6
Capital expenditure	4.1	6.2	7.7	7.3	8.0	8.5	8.9
Primary balance	**1.2**	**-2.0**	**-1.3**	**-1.6**	**-2.1**	**-3.6**	**-3.3**
Overall balance	**-0.4**	**-3.7**	**-2.8**	**-2.7**	**-2.8**	**-4.2**	**-3.9**

a. Only major items are included.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

compensation fund for lost customs revenue also affected the Union's transfers.

The fiscal and lending policies set out by the Central Bank of West African States (BCEAO) have remained cautious, thus checking inflationary pressures and maintaining a suitable level of foreign currency reserves.

The health of the Nigerien banking system – which is comprised of eight banks and one financial institution – is, on the whole, satisfactory. The majority of local banks adhere to the prudential rules of the regional banking commission. A new institution, the Sahel-Saharan Investment and Trade Bank (BSIC), received regulatory approval in July 2003 and is now in the process of setting up a subsidiary network in the 18 member states of the Community of Sahel-Saharan States. The Nigerien economy is very poorly equipped with banking facilities and just 12 per cent of GDP originates from the banking sector, well below the WAEMU 2003 average of 27.6 per cent.

External Position

Niger has a structural deficit in its balance of trade. The coverage ratio (ratio of exports to imports), which has fallen appreciably in the last three years, was at 65.7 per cent in 2004. The decline recorded in 2004 was attributable to increased imports, particularly of equipment (+48 per cent) and telecommunications material. Re-exports to Nigeria, which increased strongly in 2003, declined in 2004 negatively affecting tax revenues. Niger remains highly dependent on foreign imports for basic food supplies, energy and industrial products (Table 3). One of the country's goals is to reduce its current account deficit, which grew from 7.8 per cent in 2002 to 7.6 per cent in 2003 before falling to 7.3 per cent in 2004. This decline should continue. From 2005, gold extraction and diversification of agricultural exports should contribute to improving the current account. Since the end of 2001, the effective real exchange rate increased by 5 per cent, reflecting the strengthening of the euro against the dollar. The national currency is fixed to the euro, with the exchange rate at 655.96 CFA francs to the euro. It thus fluctuates with the euro against the dollar.

France is Niger's largest supplier, accounting for 17 per cent of imports. Despite the crisis in Côte d'Ivoire, which led to increased transportation costs, that country remains in second place (accounting for 15 per cent of imports). Exports are concentrated on a small number of countries and products. Nigeria is the first destination, followed by France. Trade to Nigeria is primarily composed of livestock, food products and re-exports of cigarettes and textiles. In the opposite direction, Niger imports oil products and manufactured goods and food from Nigeria. These, often informal, exchanges provide those with extremely low purchasing power access to both a source of revenue and consumer goods.

In order to reduce the current account deficit, the government plans to increase uranium and food-processing exports and to limit the rise of imports.

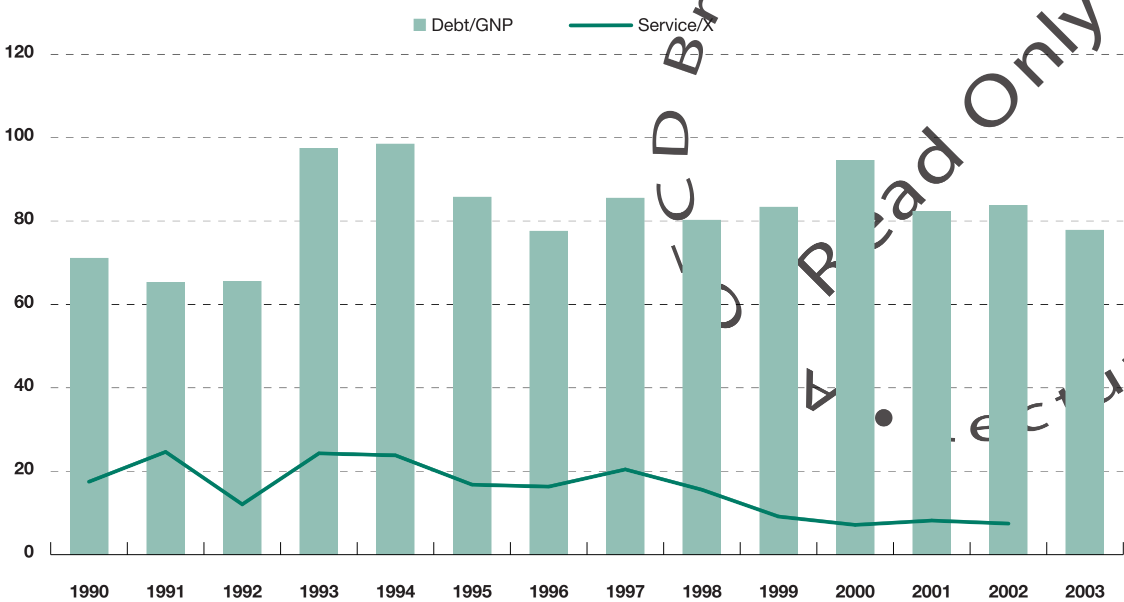
The programme adopted by the authorities to discharge internal debt has enabled them to reduce arrears. At the end of 2003, the external debt stock was estimated at 226.5 billion CFA francs. A new computer programme, intended to allow more efficient

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-1.3	-3.0	-4.2	-4.9	-5.4	-5.8	-5.8
Exports of goods (f.o.b.)	16.4	14.0	12.9	12.3	12.0	11.7	11.6
Imports of goods (f.o.b.)	-17.7	-17.0	-17.1	-17.2	-17.5	-17.5	-17.4
Services	-6.0	-6.5	-6.0	-6.4			
Factor income	-1.4	-0.8	-1.1	-0.5			
Current transfers	3.2	3.7	3.5	4.2			
Current account balance	**-5.5**	**-6.6**	**-7.8**	**-7.6**			

Source: IMF data; estimates (e) and projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

management and analysis, should lead to better debt monitoring.

The completion point of the HIPC Initiative was reached on 8 April 2004. To adhere to the HIPC Initiative goal of maintaining a debt to export ratio of below 150 per cent, the country's bilateral and multilateral creditors conceded additional aid to Niger (the Paris Club provided a top-up of 4 million dollars). Since reaching decision point in 2000, Niger has suffered from exogenous shocks (a difficult uranium market, weak dollar), which explain the deterioration in the debt to export ratio. The country finally had its Paris Club debt erased (185 million dollars). Spain, the United States, France, Japan and the United Kingdom, as members of the Paris Club, are all involved in this debt restructuring. The country is now negotiating a similar treaty with its non-Paris Club bilateral creditors. According to the IMF, only Kuwait has agreed to HIPC debt relief. At the end of 2002, the nominal value of Niger's debt (non-Paris Club) was 230.9 million dollars. None of the country's commercial debt, which was 4.6 million dollars at the end of 1999, has been forgiven. The HIPC Initiative will enable the country to bring its debt ratio from 68.8 per cent of nominal GDP in 2004 to 58.3 per cent in 2006, in addition to reducing debt servicing charges.

Structural Issues

The Nigerien private sector is dominated by the informal sector and by a concentration of activity in trade and services. No database for small and medium enterprises (SME) exists. The sole definition of SMEs in use is that of the investment code, which dates from 1989 and which classifies companies according to the level of their investment. Those companies investing between 50 and 200 million CFA francs (around 94 500 and 377 000 dollars) are defined as small, while those investing between 250 million and 1 billion CFA francs (472 000 and 1.9 million dollars) are considered medium sized.

The strategy for promoting SMEs focuses on developing opportunities that exploit the country's comparative advantage. Several support structures have been put into place. The government programme to support private initiatives and create jobs (PAICE), under the Ministry of Commerce, is composed of three funds. These include, a research fund (*Fonds d'aide aux* *etudes*, FAE), a contribution fund (*Fonds d'intervention et de participation*, FIP) and a guarantee fund (*Fonds de garantie supplémentaire*, FGS). Together, it is hoped that they will: *i)* facilitate project research financing; *ii)* supplement the personal contribution of developers, such as young graduates, when their resources are insufficient; and *iii)* facilitate access to bank loans by helping developers gather the guarantees required by banks. With support from the European Development Fund (EDF), in 1993 the Nigerien government also created an organisation to finance and support private enterprises (AFELEN). In five years, AFELEN granted 6 billion CFA francs (11.3 million dollars) in loans to 205 companies, investing a total of 10.6 billion CFA francs (20 million dollars). However, the project's continued existence is threatened by the increased number of delayed and unpaid loans and numerous malfunctions. Grants of new loans ceased in 1996 and since 1998, AFELEN has focused on recovering its loans.

The privatisations of SONITEL (Nigerien telecommunications company) and SNE (Nigerien water company) took place in 2002. Since then, almost no progress has been made in structural reform. The restructuring of the national postal service (*Office national des postes et de l'épargne*) should be pursued. After a first attempt to open the capital of the Nigerien oil company, SONIDEP, to oil-sector professionals proved unsuccessful in 2003, a new call to tender was launched in 2004. The privatisation of NIGELEC (the national electricity company) also had to be delayed as insufficient capital was raised to ensure its restoration. Its management was handed over in a 25-year concession to a consortium made up of the Nigerian Electric Power Authority (NEPA) and Vivendi. At the beginning of 2004, the World Bank approved a 5.5 million dollar payment to finalise the SONIDEP and NIGELEC privatisations.

Niger's principal urban centres are equipped with modern telecommunications systems. Internet connections are effective, network access is progressively improving and Internet kiosks are proliferating in large towns. Private telephone lines remain very limited, particularly outside Niamey. The country has a national network of asphalt roads, going from Niamey (in the west) to the east of the country, with branches leading north to the border with Mali, Tahoua, Agadez and Arlit. The renovation of the road network – financed by the EU – and construction projects are underway in preparation for the francophone nation games, which will take place in the country in 2005. The renovation of the water sector has also been scheduled. Niger has an acceptable aeronautic network: the French airline, Air France, operates two flights a week to the country, and there are charter links between the capital, Niamey, and the other large economic centres. Finally, the postal system is reasonably efficient.

In the light of the incapacity of the financial sector to fulfil its role in the fight against poverty, the government has planned to restructure the banking sector and to support the development of insurance and local intermediary financing systems. In this regard, 90 per cent of the *Crédit du Niger* will be privatised, and the regional collective loan agency, the *Caisse de prêts aux collectivités territoriales* (CPCT) will be restructured. During this phase, CPCT will cease lending. The restructuring of five insurance companies will take place via the implementation of measures aimed at: *i)* strengthening their management and employee training; *ii)* paying the state's arrears to these companies; and *iii)* setting up an automobile insurance fund. The government also intends to rehabilitate the *Banque commercial de Niger* (BCN) and the *Banque islamique du Niger pour le commerce et l'investissement* (BINCI) and, using independent and local structures, to create a decentralised financial services provider throughout the country governed by a specific legal and regulatory framework. Since 30 December 2003, the Bank of Africa – Niger (BOA-N) has been the leading stock listed on the regional exchange (BRVM). Finally, the audit of microfinance organisations was begun in 2004 and the government intends to restructure the national post office in order to restart its financial services. Progress in this direction has been made, with the completion of initial studies. These examined restructuring postal services and creating a financial services arm of the post office. The terms of reference of the actuarial audit of the national social security fund (*Caisee nationale de sécurité sociale* CNSS) were finalised in June 2003, although an agreement with the

International Labour Organization (ILO) that would lead to the audit had yet to be reached.

Political and Social Context

The socio-political environment in Niger remains fragile, and social tensions have been increased by unpaid salary arrears, as well as by the threat of a new Tuareg rebellion in the north of the country. This has arisen following rumours that the former Tuareg rebels (ex-members of the Liberation Front of Aïr and Azaouak – FLAA) who had been integrated into the army under the 1995 peace accords were demobilising. However, the Nigerien authorities are pursuing a proactive policy of dialogue. In April 2003, a national strategy for conflict prevention and management was agreed upon by the government, civil society, political parties and unions. In a meeting of an *ad hoc* committee for conflict prevention in January 2004, the creation a national council for political dialogue (*Conseil national de dialogue politique* CNDP) was agreed. Its existence was sanctioned by presidential decree and then adopted by the various political parties and inserted into their charters. The participants subscribed to:

- ensure equal access to the media for all legally recognised political parties;
- ensure greater freedom of expression by a revision of the law of the press lifting some of its strict measures;
- set up a commission to draft statutes for the opposition; and
- devise mechanisms for conflict resolution within political parties via a detailed code of political ethics.

In April and May 2004, strikes were organised by the teachers and labour unions (the *Syndicat national des enseignants du Niger* and the *Confédération démocratique des travailleurs du Niger*) demanding that the government withdraw the government workers' pension plan introduced in 2000 and that it settle the salary arrears bill.

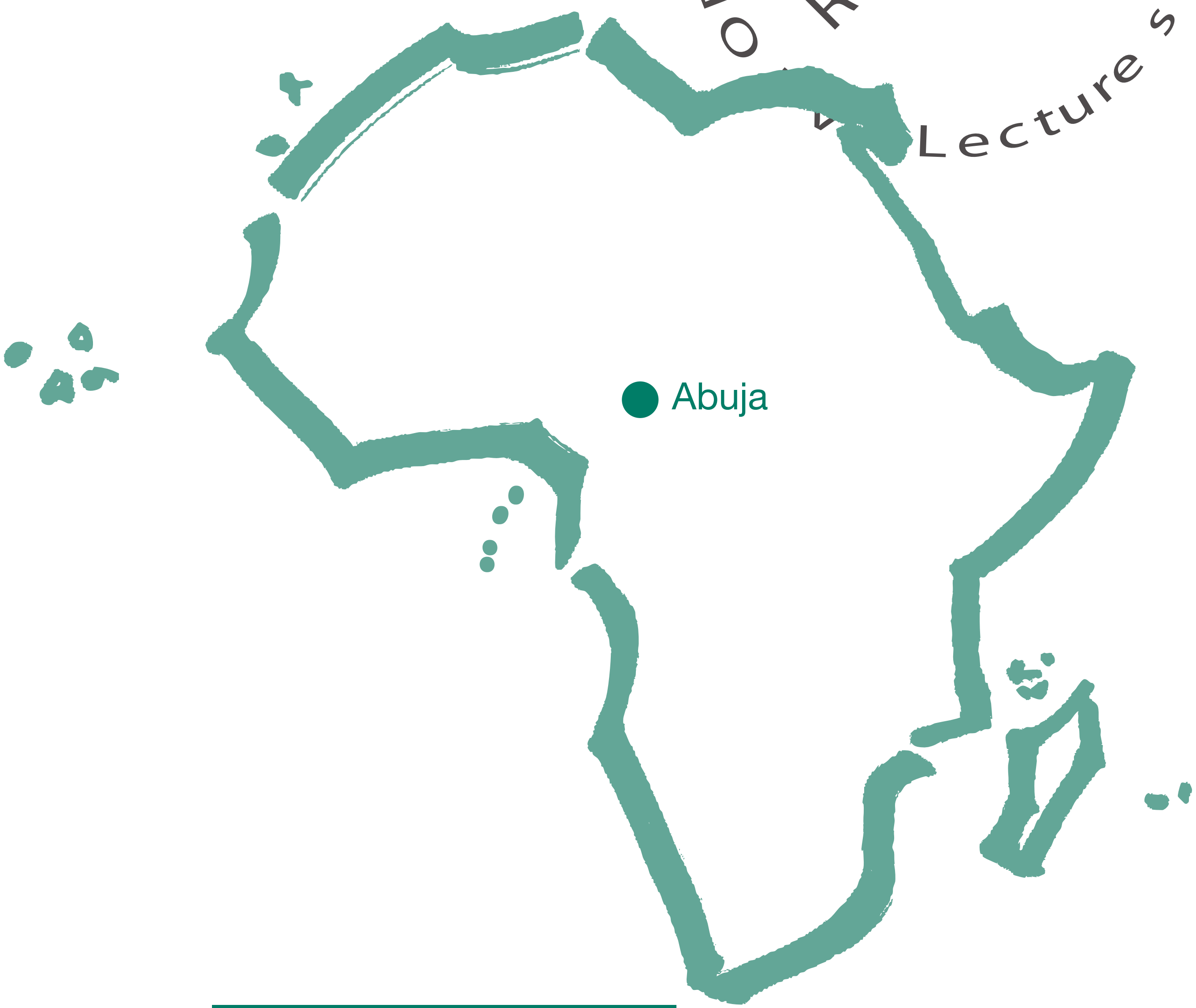
While political activity was high in 2004 with the December presidential elections, they subsequently quietened with the re-election of President Tandja with more than 65 per cent of the vote. Niger has thus held its second peaceful democratic elections, becoming a model of stability in the sub-region. Underlining this is President Tandja's position as acting president of WAEMU and the Economic Community of West African States (ECOWAS).

Women, who account for more than half of the population, are particularly affected by poverty. In accordance with the poverty reduction strategy adopted by the government, efforts must be made to reinforce public structures, civil society organisations and the private sector. In June 2004, to this effect the African Development Fund (ADF) met in Tunis and approved a 4.41 million dollar loan to Niger. This aid is intended to help increase gender equality.

Gross primary enrolment (38.1 per cent in 2001/02) and literacy (18.2 per cent in 2004) are low and the population's health is delicate. Maternal and infant mortality are the highest in the sub-region (respectively, 7 and 126 per thousand). Measures have been undertaken to improve the situation.

HIV/AIDS (1.2 per cent) is one of the lowest in Africa. Niger has 60 000 people infected with HIV, and almost 6 000 of these are sick. There is a shortage of reagents in the country, yet these are indispensable to screening. The fight against AIDS began in 1987, following the detection of the first cases and the country's AIDS programme concentrates on public education campaigns, training health professions, opening screening laboratories and improving the security of blood transfusions.

Nigeria



key figures

- Land area, thousands of km² 924
- Population, thousands (2004) 127 117
- GDP per capita, $ (2003) 471
- Life expectancy (2000-2005) 51.5
- Illiteracy rate (2004) 30.6

THE RETURN TO CIVILIAN RULE IN 1999 with the election of President Obasanjo has given rise to hopes that Nigeria will finally begin to fulfil its enormous economic potential. Until recently, the country had little to show for some $300 billion in oil revenues earned since independence. President Obasanjo's ambitious economic reforms aim to combat entrenched corruption and reduce poverty while establishing macroeconomic stability. So far, however, little progress has been achieved in overcoming obstacles to private sector development such as unreliable electric power, lack of access to financing for small and medium enterprises, and a pervasive climate of strife and insecurity.

The Nigerian government has adopted a comprehensive strategic plan for addressing the deep-rooted economic and structural problems of the country. Real GDP growth has been buttressed by the continuing high price of crude oil and an improving macroeconomic environment. Prudence in fiscal management led to a surplus in 2004. The government's fiscal restraint also supported the monetary authority's objectives of keeping growth of monetary aggregates under control, reducing inflation and limiting interest rate volatility. High oil prices reduced pressure on the balance of payments in 2004, with a resulting increase in gross international reserves. Nevertheless, Nigeria is still seeking a restructuring of the debt through rescheduling as well as debt forgiveness, following the worsening of the burden of debt through 2003. Although some progress has been made in removing structural bottlenecks in the economy, there is still a long way to go in areas such as privatisation. While the recent democratisation process and liberalisation policies have created a more favourable business climate, severe constraints continue to hamper private sector development, including growth of small and medium enterprises (SMEs).

The comprehensive strategic plan should address the deep-rooted economic and structural problems that hampered growth.

Figure 1 - **Real GDP Growth**

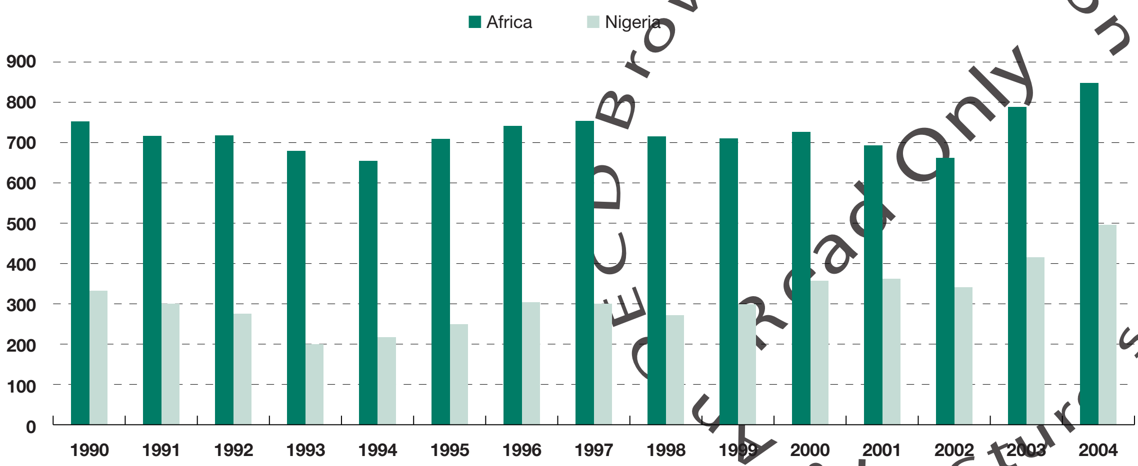
Source: IMF and domestic authorities data; estimates (e) and projections (p) based on authors' calculations.

The government is making efforts to expand access to credit for SMEs, but numerous obstacles remain. The political climate has remained calm after the 2003 elections, but the threat of instability is underscored by continuing religious and ethnic conflicts. Poverty remains dire and the key social services of health and education have failed to improve significantly over the years in spite of increased budgetary allocations.

Recent Economic Developments

In 2004, the government put forth a comprehensive strategic vision for addressing the country's deep-rooted

Figure 2 - **GDP Per Capita in Nigeria and in Africa** (current $)



Source: IMF.

macroeconomic instability and structural bottlenecks. The *National Economic Empowerment and Development Strategy* (NEEDS) is considered to be the equivalent of a home-made Poverty Reduction Strategy Paper (PRSP), covering the four-year period 2004 to 2007. NEEDS aims to make the private sector the engine of growth, through privatisation, deregulation and liberalisation, accompanied by infrastructure development, especially in electricity and transport. NEEDS also develops strategies for agriculture, industry, services, oil, gas and solid minerals. The programme has four essential objectives: *i)* to redefine the role of government in the economy; *ii)* to create an enabling environment for the private sector; *iii)* to improve the delivery of social services; and *iv)* to seek debt reduction from the international community. NEEDS sets a growth objective of 6 per cent per annum, led by the agricultural and manufacturing sectors, rather than oil.

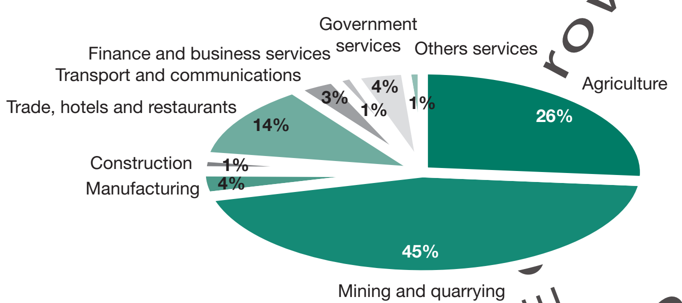
Largely as a result of the oil price increases, real GDP growth picked up strongly to 10.7 per cent in 2003 and was estimated to have reverted to 4 per cent in 2004. In addition to the effects of higher oil prices, improvements have also been recorded in agriculture, utilities, communications, building and construction and services. Growth is expected to remain satisfactory at a projected 6 per cent in 2005 and 5 per cent in 2006 aided by improved investment levels.

Agricultural production has continued to expand as a result of favourable weather conditions and improved government policies, growing an estimated 6.8 per cent in 2004 compared to 6.1 per cent in 2003. All the major staple and cash crops recorded higher output in 2004. However, the achievement of higher output levels is hampered by inadequate supply of fertilisers and other farming inputs. In addition, natural hazards including the perennial problems of quela bird invasions and flooding in some farming areas such as Jigawa, Kano and Kabbi, continue to hold down growth.

Bans on the import of cassava, fruit juices, vegetable oil and poultry and related products boosted local production, although such bans may eventually lead to smuggling. The special rice programme, as well as the root and tuber expansion programme aimed at achieving self-sufficiency in rice and root and tuber production, also contributed to increased output.

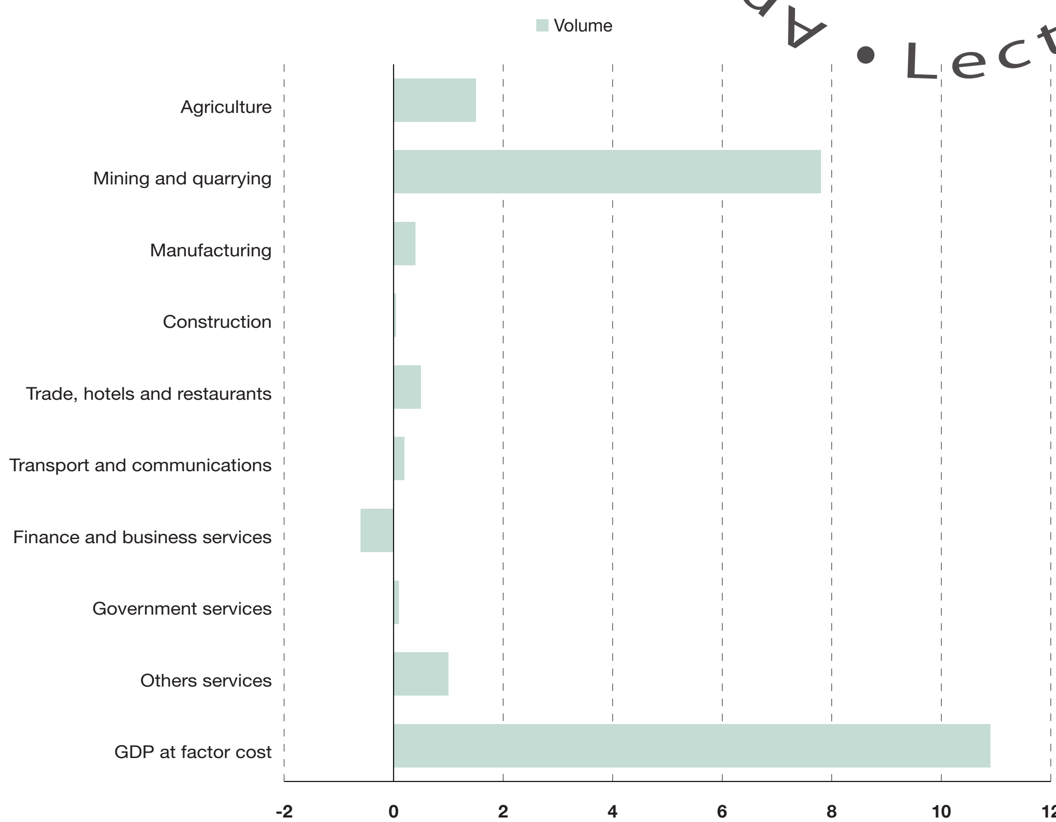
Industrial output has increased along with production of crude oil. However, the manufacturing and electricity sub-sectors continue to stagnate. In 2004, Nigeria's crude oil output was estimated at an average of 2.33 million barrels per day (mbd), compared with an average of 2.018 mbd in 2003. Increased natural gas production accompanied rising oil output. A major problem for Nigeria's oil sector remains unrest in the Niger delta region, as well as sub-optimal performance of local refineries, leading to domestic shortages of petroleum products. The domestic

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: : Authors' estimates based on domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: : Authors' estimates based on domestic authorities' data.

shortages may also be the result of smuggling, as Nigeria has maintained artificially low prices on its domestic market.

Output of other industrial sub-sectors, especially manufacturing and electricity generation, continued to stagnate in 2004 as communal unrest in the gas/oil production areas disrupted gas transportation through pipelines to the plants. Shutdowns for rehabilitation also reduced electricity generation.

Reduced electricity supply and the generally poor condition of basic infrastructure continued to hamper manufacturing. Most industries are forced to rely on their own generators, as the Nigeria Electricity and Power Authority (NEPA) remains unreliable. Frequent power outages and tension fluctuations have adverse effects on machinery. In 2004, surveys revealed that about 56 per cent of energy requirements of industry were privately generated. The World Bank estimates that the effective cost of electricity increases by 30 per cent as a result of these dysfunctions. The deplorable energy situation has also contributed to low capacity utilisation in Nigerian manufacturing, estimated at 46.2 per cent in a 2003 survey. Sectors recording higher than 50 per cent capacity utilisation tend to be those using imported inputs, making them less dependent on local infrastructure.

Expansion in telecommunications continued to lead growth of the service sector, with telephone density increasing from 1 per 165 people in 2001 to 1 per 49 people in 2003. Since the liberalisation of telecommunications in 2001, private operators have brought about innovation, wider coverage, competition, and financing for investment. However, severe operational inefficiencies continue to limit the sector. For instance, the Nigerian Telecommunications Limited (NITEL) increased its telephone lines by 20.3 per cent in 2003 but only 50 per cent of its lines are functional.

The government's share of aggregate expenditure declined in 2004. Also, both public and private gross capital formation in the economy remained subdued in 2004, suggesting that the climate for private investment still leaves much to be desired.

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**14.4**	**22.8**	**26.1**	**22.8**	**22.7**	**23.5**	**25.3**
Public	5.1	12.1	10.2	9.3	9.3	10.1	10.9
Private	9.3	10.7	15.9	13.4	13.4	13.4	14.4
Consumption	**75.1**	**68.3**	**74.2**	**68.3**	**63.4**	**60.1**	**61.0**
Public	8.3	26.5	24.7	23.3	21.8	20.2	20.4
Private	66.8	41.8	49.5	45.0	41.6	39.9	40.6
External sector	**10.5**	**8.9**	**-0.2**	**8.9**	**13.8**	**16.4**	**13.7**
Exports	46.9	43.3	40.8	49.9	51.9	52.4	49.4
Imports	-36.4	-34.4	-41.0	-41.0	-38.0	-36.0	-35.8

Source: Domestic authorities' and IMF data; estimates (e) and projections (p) based on authors' calculations.

Macroeconomic Policies

Fiscal and Monetary Policy

Key measures introduced in 2004 as part of the NEEDS agenda of fiscal consolidation include *i)* the enforcement of a civil service hiring freeze, the conducting of a payroll audit, and physical verification of personnel in selected ministries; *ii)* imposition of hard budget constraints on federal parastatals; *iii)* development of an equitable and affordable strategy for clearing pension arrears.

The government's prudent fiscal policies in 2004, combined with high oil prices and the removal in 2003 of the subsidy on domestic crude oil sales to the Nigerian National Petroleum Corporation (NNPC), led to improvement in budgetary outcomes. In May 2004, the government increased retail prices of petroleum products only to lower prices again in the face of organised union protests; in effect, some element of subsidy remained on petroleum products. Moreover in 2004, the capital budget was streamlined by establishing criteria for prioritising development projects, with priority given to projects that could be completed within the year.

Total revenue rose to an estimated 40.6 per cent of GDP in 2004, up from 36.5 in 2003, thanks to the windfall of high oil prices. The overall budget balance consequently moved to an estimated surplus of 7.4 per cent of GDP from the deficit of 1.4 per cent of GDP in 2003. The 2004 appropriations bill was based on a crude oil price of $25 per barrel whereas the actual price averaged $35 during the year. The government adopted a policy intended to smooth expenditure by saving windfalls when oil prices are high, and was able to save about $2 billion of the excess receipts in 2004.

The budget is expected to remain in surplus in 2005 and 2006.

The prospect of continued high oil prices has led the government to raise the assumption of average crude price from $27 per barrel in 2005 to $30 per barrel in setting the budget.

The government's prudent response to the oil windfall is manifested in the continued decline in current expenditure. Total government expenditure fell to an estimated 33.2 per cent of GDP in 2004 from 37.9 per cent of GDP in 2003, while current expenditure fell to an estimated 12.2 per cent of GDP in 2004 from 13.6 per cent of GDP in 2003. In 2004 the government strengthened the budget process and improved expenditure co-ordination through the introduction of the Cash Management Committee (CMC) which monitored and reconciled monthly expenditure releases, and determined that borrowing requirements were consistent with cash flow projections. Also, with the computerisation of payrolls in some ministries the government was able to weed out a large number of phantom workers, contributing to a fall in the wage bill. In the Federal Capital Territory alone over 3 000 phantom workers were eliminated in the course of 2003/2004, saving the government naira 58 million each month. The government also focused on enhancing transparency and accountability in its expenditure. To improve public procurement, the government established the Budget Monitoring and Price Intelligence Unit (BMPIU) which is charged with oversight of public sector contracting and procurement. Furthermore, in 2004, the government initiated a Public Procurement Commission and joined the Extractive Industries Transparency Initiative, a British-inspired code under which oil, gas and solid mineral exporting countries agree to combat secrecy and corruption.

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total Revenue and grants[a]	**20.0**	**42.1**	**36.2**	**36.5**	**40.6**	**40.2**	**38.1**
Tax revenue	6.3	8.5	8.5	7.9	7.3	7.0	6.8
Oil Revenue	13.5	32.8	26.5	28.0	32.6	32.6	30.6
Total expenditure and net lending[a]	**15.0**	**47.0**	**41.4**	**37.9**	**33.2**	**34.0**	**32.9**
Current expenditure	5.5	14.9	16.2	13.6	12.2	10.7	10.2
Excluding Interest	*3.1*	*8.8*	*9.8*	*8.6*	*8.0*	*7.5*	*7.6*
Wages and salaries	1.5	5.3	6.5	4.9	4.4	4.0	4.0
Interest	2.3	6.1	6.4	5.1	4.2	3.2	2.6
Capital expenditure	5.3	16.3	11.0	9.3	9.3	10.1	10.9
Primary balance	**7.3**	**1.2**	**1.1**	**3.7**	**11.5**	**9.5**	**7.8**
Overall balance	**4.9**	**-4.9**	**-5.3**	**-1.4**	**7.4**	**6.3**	**5.2**

a. Only majors items reported.
Source: Domestic authorities' and IMF data; estimates (e) and projections (p) based on authors' calculations.

Nigeria's monetary policy continues to aim at achieving single-digit inflation, a stable naira, and a stock of foreign-exchange reserves equivalent to at least six months of current imports. The current monetary regime uses a two-year framework to help even out the lagged effects of policy shocks. The Central Bank of Nigeria (CBN) relies on open market operations to control growth in monetary aggregates; changes in the minimum re-discount rate (MRR) to determine interest rates, and a Dutch auction system to determine the value of the naira. Since 2003, open market operations have been conducted on a daily basis instead of bi-weekly to exert greater control over financial market conditions.

Hitherto, monetary aggregates have tended to overshoot the CBN's targets due largely to the expansionary fiscal policies. However, in the first nine months of 2004, as a result of the fiscal surplus, annualised growth in broad money supply (M2) was only

13.2 per cent, compared with the expansion of 24 per cent recorded in 2003. The expansion in the money supply in 2004 was largely fuelled by credit to the private sector, as credit to the government contracted.

Year-on-year annual inflation moderated to an estimated 13.4 per cent in 2004 after ending 2003 at 16.1 per cent and rising to 24.8 per cent in February 2004. The persistent pressure on prices in 2004 was attributable to the impact of the partial deregulation of petroleum prices in 2003, and the lagged effect of the 2003 monetary expansion. Interest rates remained largely stable in 2004. The CBN maintained the MRR fixed at 15 per cent during the year which contributed to stability in other short-term rates. It is expected that inflation will follow a downward trend in 2005 and 2006 as the continued improvement in agricultural production reduces inflation in food prices.

Nigeria maintains a system of four exchange rates, namely, the Inter-Bank Foreign Exchange Market (IFEM) used for CBN transactions; the Nigerian Inter-Bank Foreign Exchange Fixing (NIFEX), quoted by a group of commercial banks; the bureaux de change rate; and the parallel market rate. The multiple rates and segmented market are a source of distortion.

Pressure on the foreign exchange market eased in 2004 as a result of increased oil revenue and prudent fiscal policies. The naira appreciated in all segments of the market during the first half of the year and remained relatively stable thereafter reversing the depreciation trend since 2000. High oil prices also enabled an increase in gross international reserves to $13.27 billion at end-September 2004 from $7.46 billion at end-2003 and, according to the CBN, the reserve position is expected to reveal a further increase at end-December 2004. The foreign exchange reserve at end-2004 was enough to finance nine months of imports of goods and services, up from the six months coverage registered at end-2003.

External Position

Nigeria's government has opted for trade liberalisation and regional integration with the Economic Community of West African States (ECOWAS)[1], of which Nigeria is the dominant member. The ECOWAS ambitious agenda involves the creation of a customs union and partial economic union, with common trade and competition policies, a common currency under the West African Monetary Zone (WAMZ) protocol and the removal of all non-tariff barriers to trade. In practice, however, ECOWAS has made little progress to date in achieving these objectives, and Nigeria's trade barriers are frequently criticised for not being fully in conformity with WTO obligations. Nigeria continues to avail itself of tariffs and non-tariff barriers in a highly non-transparent manner, with import tariffs varying from 0 per cent to 100 per cent and some imports completely banned.

The favourable developments in the international

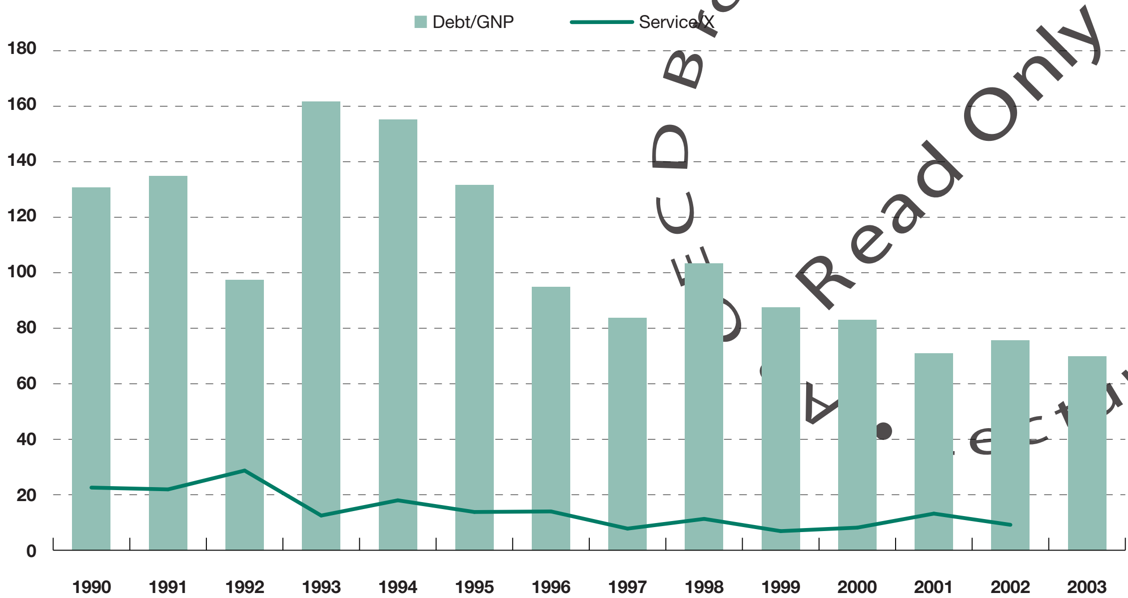
Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(e)	2006(p)
Trade balance	20.4	16.9	9.3	18.1	22.6	25.0	22.3
Exports of goods (f.o.b.)	46.3	40.8	37.8	47.0	49.5	50.5	47.6
Imports of goods (f.o.b.)	-25.8	-23.9	-28.6	-29.0	-26.9	-25.5	-25.3
Services	-9.5	-8.2	-9.6	-9.3			
Factor income	-7.5	-8.9	-13.7	-14.5			
Current transfers	2.5	2.7	3.0	2.8			
Current account balance	**-4.5**	**2.6**	**-10.9**	**-2.7**			

Source: Domestic authorities' and IMF data; estimates (e) and projections (p) based on authors' calculations.

1 The member countries of the Economic Community of West African States (ECOWAS) are Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

oil market in 2004 led to a remarkable improvement in the trade account. The trade surplus rose to 22.6 per cent of GDP in 2004 owing to continued high oil prices and a sharp reduction in imports as a share of GDP. Nigeria's exports consist overwhelmingly of crude oil (97 per cent of total exports in 2004). Nigeria's oil imports – of mainly refined petroleum products – increased in 2004 as a result of the deregulation of the downstream oil and gas sector which increased the tempo of activities in the sector.

Nigeria's total external debt and debt-servicing burden continued to rise in 2003 and stabilised in 2004. The total external debt stock rose to an estimated \$32.9 billion at end-2003 from about \$30.9 billion at end-2002 of which about 70 per cent is owed to Paris Club creditors from whom Nigeria is seeking a mix of debt relief and rescheduling.

Structural Issues

As stipulated by NEEDS, the government is aiming to restructure and liberalise the economy to attract foreign investments and spur the domestic private sector. The private sector is characterised by low productivity, inability to compete with imports, lack of diversification and an unfavourable business environment. Although Nigeria's recent move towards democracy and the accompanying liberalisation policies have set the stage for making the private sector the engine of growth, a daunting set of constraints remain: infrastructural deficiencies, pervasive insecurity, corruption and rent seeking, low access and high cost of finance, weak institutions, ill-defined property rights and enforcement of contracts, and the unstable macroeconomic environment.

Small and medium enterprises (SMEs) play a major role in the Nigeria's economy, but suffer from the above-noted constraints. Currently, about 95 per cent of the firms in the organised manufacturing sector are SMEs, accounting for about 70 per cent of industrial employment but only about 10-15 per cent of total manufacturing output.

Over the years, the government has introduced numerous financial-assistance schemes for SMEs. The Nigerian government's efforts to assist SMEs began with the Industrial Developmental Bank Ltd (NIDB) in 1962 and have continued with the creation of several other institutions such as the Nigerian Bank for

Commerce and Industry (NBCI). Moreover, until recently the government required commercial and merchant banks in the country to allocate a stipulated minimum of credit to preferred sectors including the SMEs. The Rural Banking Scheme, another major initiative started in 1977, focused more specifically on increasing credit to the agricultural sector and rural SMEs. The National Economic Reconstruction Fund (NERFUND) was set up to assist SMEs in adjusting to the Structural Adjustment Programme (SAP). The NERFUND provided relatively long-term loans (5-10 years) to SMEs at concessional rates of interest. Between 1990 and 1998, NERFUND disbursed $144.9 million (Foreign Exchange Component) and N681.5 million (Naira Component) to support 218 projects. Moreover, the government obtained a World Bank Assisted SME II Loan Project to complement other sources of funding for SMEs. This facility involved credit lines of $270 million, to be made available to SMEs through eligible participating banks. In addition, the government established a community banking scheme in 1991 with the objective of promoting rural development.

These numerous measures yielded limited success for a variety of reasons. These include the failure to remedy other deficiencies in the business environment, most notably inadequate infrastructure and pervasive corruption, with the latter connected to abuse of the various programmes by both the beneficiaries and the agencies involved. Many of the schemes were inadequately equipped and funded. Also, many of the schemes were unsuccessful because of the dearth of executive capacity to appraise, supervise and monitor projects. As a result of all this, many unviable projects were funded, leading to massive loan defaults and termination of the projects.

Recently, the government has developed new initiatives. In addition to the SMIEIS (see Box), the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) — an amalgam of the former Peoples Bank of Nigeria, Nigerian Agricultural and Cooperative Bank and the Family Economic Advancement Programme (FEAP) — was set up in 2000, primarily to finance agriculture as well as small and medium enterprises. The bank offers a number of financial products and specialised loan facilities for start-ups and smallholders. Similarly, the Bank of Industry, which is an amalgam of the former Nigerian Industrial Development Bank, the Nigerian Bank for Commerce and Industry, and the National Economic Reconstruction Fund (NERFUND), was set up in 2000 with the principal objective of providing credit to the industrial sector, including the small and medium-scale enterprises. Also, in 2002 the government introduced the Refinancing Facility (RF) at concessional interest rates to support medium- to long-term bank lending. The RF is designed to provide temporary relief to banks which face liquidity problems as a result of having committed their resources to long-term financing to the specified productive sectors. The sectors include agricultural production, semi manufacturing and manufacturing, solid minerals and information technology. Under the facility, banks shall have access up to 60 per cent of qualifying loans. Qualifying loans must have been held for not less than one year.

Although these attempts at finding solutions to the problems of credit delivery to the SMEs have achieved some successes, there still exists a huge financing gap. The limited effectiveness of these promotion schemes shows that creating institutions and schemes to provide credit is insufficient when the overall business climate remains hostile. In the case of Nigeria, the main obstacles include insecurity, corruption, and inadequate infrastructure.

The government has pursued reform of the public sector, including privatisation, albeit at a very slow pace. In 2004, the government streamlined several agencies, eliminating redundant functions. The government also initiated work to develop performance indicators in the key ministries to strengthen accountability and improve service delivery. A major reform measure introduced in 2004 was the introduction of a new contributory pension system. The privatisation process has been particularly slow, though some significant gains have been made recently, especially in the telecommunications sector. The government implemented the second and third phases of its privatisation programme between 2001 and 2004, with

SMIEIS – An Innovation in Bank Financing of SMEs in Nigeria

The concept of the *Small and Medium Industries Equity Investment Scheme* (SMIEIS) in Nigeria was the initiative of the Central Bank of Nigeria with the voluntary support and efforts of the Bankers' Committee. The Scheme requires that all banks in Nigeria set aside 10 per cent of their profit before tax annually for equity investments in small and medium enterprises. This arrangement eliminates the burden of interest and other charges associated with normal bank lending. The Scheme is therefore an innovative way of financing the real sector and it has a considerable developmental potential.

Objectives of the Scheme, among others, include facilitating the flow of funds for the establishment of new small and medium enterprises and the reactivation, expansion or restructuring of on-going projects; stimulating economic growth; development of local technology; generating employment; and management and stimulation of corporate governance in the SMEs. At the firm level, the scheme affords the SMEs, among others:

- access to long-term funding;
- access to other critical resources that follow "the money";
- disciplined approach to business and management;
- improved relationship and access to banks;
- opportunity to become part of the formal sector.

The range of activities in respect of which SMIEIS funds are applied are those in the real sector of the economy including information technology and telecommunications; manufacturing; educational establishments; services; tourism and leisure; solid minerals; and construction. The Scheme employs an innovative mechanism to ensure effectiveness through a programme in which the banks identify, guide and nurture enterprises that are financed under the scheme.

Management of SMIEIS funds requires participating banks to operate the scheme directly or through their wholly-owned subsidiary companies or through venture capital companies floated by the banks. Under the Scheme, funds invested by participating banks are in the form equity investment in eligible industries. Equity investments under the scheme may be in the form of fresh injection and/or conversion of existing debts owed to participating banks into equities.

Performance of the Scheme so far indicates that as at 31 July 2003 about N18.6 billion has been set aside by banks. However, only N4.6 billion has been actually invested in eligible companies. The slow pace of investment and the likelihood of further accumulation of un-invested funds, require that the operators take steps to give the Scheme a fresh impetus so that the present low investment can be overcome, thereby accelerating the implementation of the scheme.

The following points highlight some of the factors that need attention: *i) Ignorance:* many of the promoters of SMEs demonstrate outright ignorance on the difference between loans and equity. This may require the banks to embark on public enlightenment campaigns in order to become more visible. The banks may also need to carry out enlightenment of the Scheme to their staff in the operations units and branches. *ii) Wrong perception about the Scheme:* Some potential SME entrepreneurs see the Scheme as yet another loan scheme and a "National Cake" to be shared. As a result initial business proposals prepared by the entrepreneurs were in several cases bloated to attract investment. *iii) Fear of Loss of Control:* Some of the small and medium enterprises shy away from equity participation by banks in their businesses for fear of losing control of their businesses to the banks. This may be the result of inadequate information about the Scheme. *iv) Poor Management Structure:* In most instances, formal management structures are usually not in place in the SMEs.

very slow progress. Nonetheless, the sale of government equity in cement, petroleum marketing and banking companies through open, competitive bidding marked progress towards transparency. The televised auction of digital mobile phone licenses was also hailed as one of the most transparent license auctions ever held in Nigeria. The government is pursuing its programme to unbundle the Nigerian Electricity and Power Authority (NEPA) which it expects to accomplish in 2005.

The banking system's financial soundness has been reinforced recently. In 2004, the government introduced a minimum risk-weighted capital adequacy ratio of 10 per cent which banks have apparently satisfied. Similarly most banks appeared to meet the minimum paid-up capital base requirement of naira 2 billion by end-2004. However, the persistence of the oligopolistic structure of the banking system represents a challenge to the authorities' goal of greater competition in the banking sector. In 2004 only 10 banks out of the 89 in operation accounted for nearly 60 per cent of total assets and total deposit liabilities and about 45 per cent of total credit.

Political and Social Context

Nigeria's political situation appears to be stable following the elections in May 2003 which returned President Obasanjo and the People's Democratic Party to a second term in office. Although irregularities had been noted in some parts of the country in the conduct of the elections, and the opposition contested the outcome, the elections were viewed as generally free and fair by international observers. However, the fragility of Nigerian democracy is underscored by continuing ethnic and religious clashes. In May 2004, the government declared a six-month state of emergency in Plateau State in response to escalating violence. Though the various clashes have ethnic or religious dimensions, they also reflect struggles over land use and control of resources in an environment of widespread poverty and disillusionment.

Nigeria is consistently rated as one of the most corrupt countries in the world. However, the government has recently developed new anti-corruption initiatives. In 2004, the government won legislative approval to revise the *Anti-Corruption Bill* and to tighten the *Economic and Financial Crimes Bill*. Further, in 2004, the government established the Independent Corrupt Practices and Other Related Crimes Commission (ICPC) as well as the Economic and Financial Crimes Commission (EFCC). The work of the ICPC and the EFCC has been complemented by reforms of the judiciary system and the police, focusing on recruiting and training more staff, providing more equipment and improving wages. However, the real test of the government's determination to reduce corruption will be the extent to which it prosecutes high-level offenders.

In spite of Nigeria's oil wealth, social indicators are among the lowest in the world, with a Human Development Index ranking of 152nd out of 175 countries in 2004. The government's own statistics indicate that the poverty rate has increased from an average of about 27 per cent in the 1980s to over 70 per cent in 2003. The NEEDS anti-poverty objectives involve *i)* increasing average per capita consumption by 2 per cent annually, and *ii)* creating about 7 million jobs over the 2004-2007 period. The government's actions, however, will need to be complemented by a lessening in political tension, and communal, ethnic and religious violence, which in the past has hampered efforts to alleviate poverty.

The government places particular emphasis on health and education, where outcomes have not improved significantly over the years despite large expenditures (5 per cent of GDP for health alone in 2003). The slow pace of rehabilitation of basic facilities and the numerous strikes in education and health sectors continue to hamper service delivery.

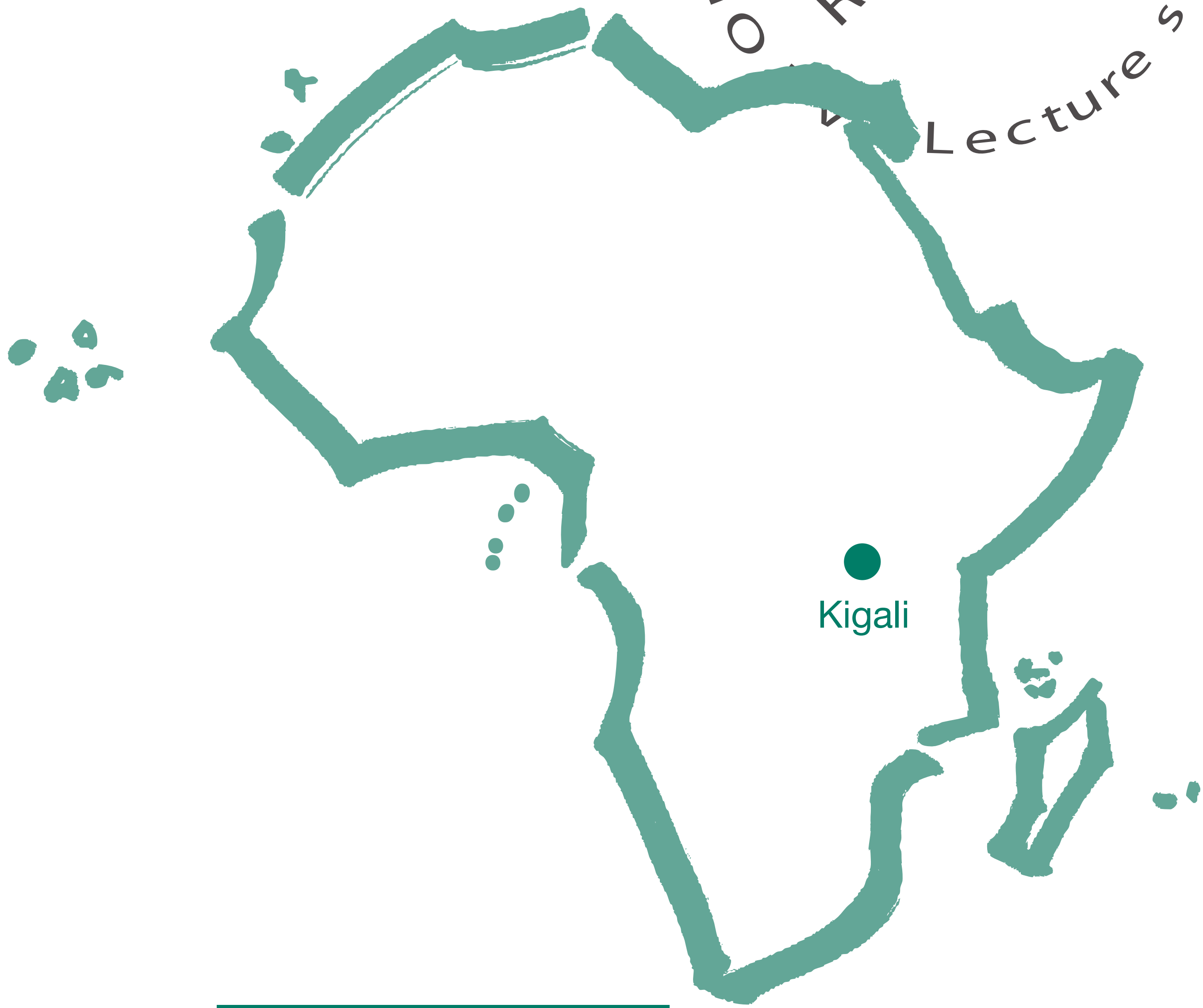
The current life expectancy is 54 years and infant and maternal mortality rates remain high at 77 and 7 per 1 000 births, respectively. There are fewer than 30 doctors per 100 000 citizens and the proportion of children fully immunised against the five most lethal diseases has dropped from 30 per cent in 1990 to 17 per cent in 2003. Nigeria also has a growing HIV/AIDS problem. The HIV infection rate rose from

4.5 per cent in 1995 to 6 per cent in 2003. The 4 million infected Nigerians represent more than 10 per cent of all infected Africans, or over 8 per cent of the global total.

The government has recognised the magnitude of the HIV/AIDS menace and is pursuing treatment initiatives that are novel in Africa. Under the programme, started in 2003, the government is distributing generic anti-retroviral drugs at less than 10 per cent of the cost of brand name drugs or less than one US dollar per day. In addition, the government is continuing to emphasise prevention and plans to introduce a new National Health Policy applicable to all three tiers of government.

The government continues to prioritise free Universal Basic Education (UBE) for all pupils at the primary and junior secondary school level. In addition, NEEDS focuses on reviewing curricula with a view towards incorporating vocational and entrepreneurial training and information and communications technology. While increased spending on education has enabled rehabilitation of schools and contributed to improvements in enrolment in primary and secondary schools, there is no progress in female primary school enrolment which at the current level of less than 50 per cent has shown no change for nearly a decade. Similarly, no improvement has been registered in the adult illiteracy rate which at 43 per cent in 2004 has remained unchanged for about a decade. As a result of UBE, the education system now faces the challenge of finding places for over 6 million students who will become eligible for university education in 2010, compared to the current capacity for fresh admissions to Nigeria's existing 53 universities of about 166 000.

Rwanda



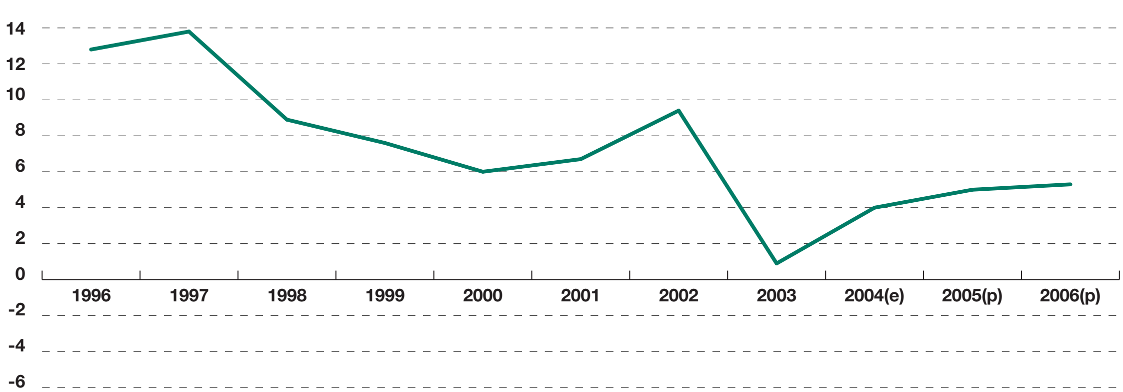
key figures

• Land area, thousands of km²	26
• Population, thousands (2004)	8 481
• GDP per capita, $ (2003)	201
• Life expectancy (2000-2005)	39.3
• Illiteracy rate (2004)	28.4

FOLLOWING THE 1994 GENOCIDE, Rwanda has made remarkable progress during the last ten years. The average real GDP growth between 1995 and 2004 was 8 per cent. Rwanda, however, remains highly dependent on foreign aid which, during 2000-04, accounted for about 50 per cent of the current budget and about 80 per cent of the development budget, even though the share of government revenues to GDP has recently increased. Progress in Rwanda's structural transformation has remained slow, as a stagnating manufacturing sector (as a share of GDP) indicates. Little progress has also been made in increasing exports which, combined with continuously high debt financing, implies a worsening of Rwanda's external debt sustainability. While the poverty rate increased sharply from 47.5 per cent in 1990 to 78 per cent in 1994, it has declined steadily since 1994, reaching about 60 per cent in 2000. Yet, given that Rwanda's poverty line is defined as living below the cost of a basket of basic goods and services, which was equivalent to about $0.45 a day in 2000, Rwanda remains one of the poorest countries in the world. Overall achievements in health policies and outcomes are significant, especially with regard to immunisation rates, although progress relative to some indicators remains slow (including the percentage of underweight children). Considerable progress has also been made in education. Based on the sharp increase in primary school enrolment ratios over the last few years, Rwanda could reach universal enrolment by 2010. The proportion of girls in primary schools is on a par with that of boys. Rwanda, which was among the poorest countries in terms of the human development index (HDI) during the late 1990s, ranked 159 out of 177 countries in the Human Development Report 2004. Rwanda has been identified as a potential candidate for the Millennium Development Goals (MDG) fast-tracking which, if realised, would give Rwanda a considerable boost in terms of poverty reduction and growth[1]. Finally, while significant progress has been made in terms of internal and external reconciliation, regional instability remains a threat.

Good policies and improved relations with neighbours are pivotal to continued international support and reconstruction.

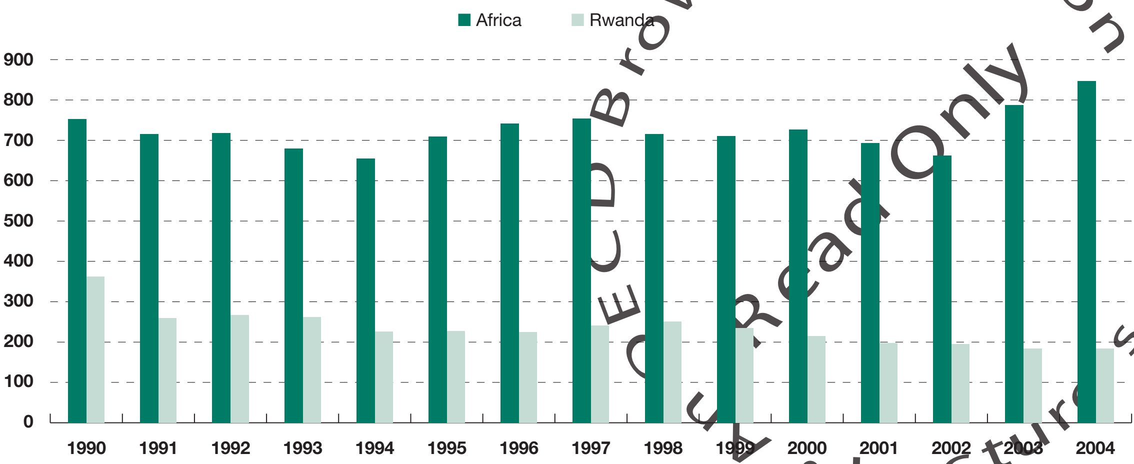
Figure 1 - **Real GDP Growth**



Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

1. See the Millennium Project's Report to the UN Secretary-General *Investing in Development – A Practical Plan to Achieve the Millennium Development Goals*, January 2005

Figure 2 - **GDP Per Capita in Rwanda and in Africa** (current $)



Source: IMF.

Recent Economic Developments

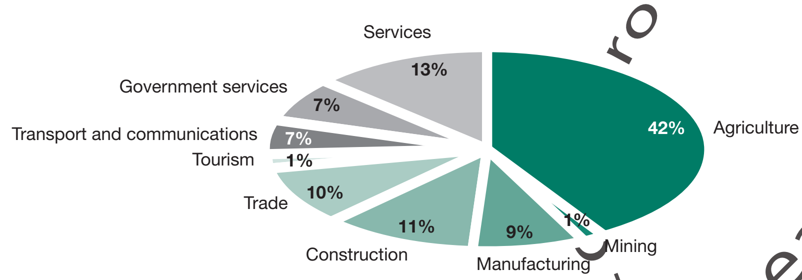
Following the strong performance achieved since Rwanda began to reform its economy in 1995, economic growth collapsed in 2003. Real GDP growth fell from 9.4 per cent in 2002 to 0.9 per cent in 2003 – mostly due to unfavourable weather conditions – which led to a contraction in key agricultural output of 3.1 per cent in 2003. Real GDP growth recovered partly in 2004, with an estimated real GDP growth rate of around 4 per cent[2]. Furthermore, given the considerable human resource constraints that Rwanda continues to face, Rwanda's economy remains highly vulnerable to exogenous shocks.

Agriculture remains with 41.3 per cent of GDP the strongest sector, as over 90 per cent of Rwanda's 8.4 million population rely on subsistence agriculture. Together with previous price deteriorations of Rwanda's main exports, the 2003 drought implied a considerable setback for the Rwandan economy. Even though Rwandan coffee prices increased by 36 per cent in 2003, the export volume of coffee, which was historically Rwanda's main cash crop, fell by 25.7 per cent from 2002 to 2003. The export volume of tea, which was historically Rwanda's second most important cash crop, fell by 1.7 per cent from 2002 to 2003. Hence, the export values of tea have overtaken those of coffee for the fourth year. With overall favourable weather conditions experienced during 2004 and recent price improvements, export volumes for coffee and tea are estimated to have grown close to 25 per cent in the first ten months of 2004. Rwandan coffee farmers are also in the process of shifting their production from low to high quality coffee to achieve higher prices. Production of food crops (including bananas, roots and tubers) contracted by 11.2 per cent in 2003, compared to the 2002 bumper harvest, when production increased by 38.9 per cent (based on national accounts data that are currently being revised). There are indications of a recovery in 2004 as the government, supported by donors (including the ADB-supported Inland Lakes Integrated Development and Management Project), has promoted the use of improved seeds, intensified the production, and expanded cultivation areas.

The industrial sector grew by 4.4 per cent in 2003, on the strength of construction and public works which increased by nearly 15 per cent, while manufacturing and mining activities contracted and output in electricity, gas and water (if taken together) remained constant in real terms. The service sector grew by 4.8 per cent in 2003, on the strength of public administration, which grew by close to 10 per cent, while

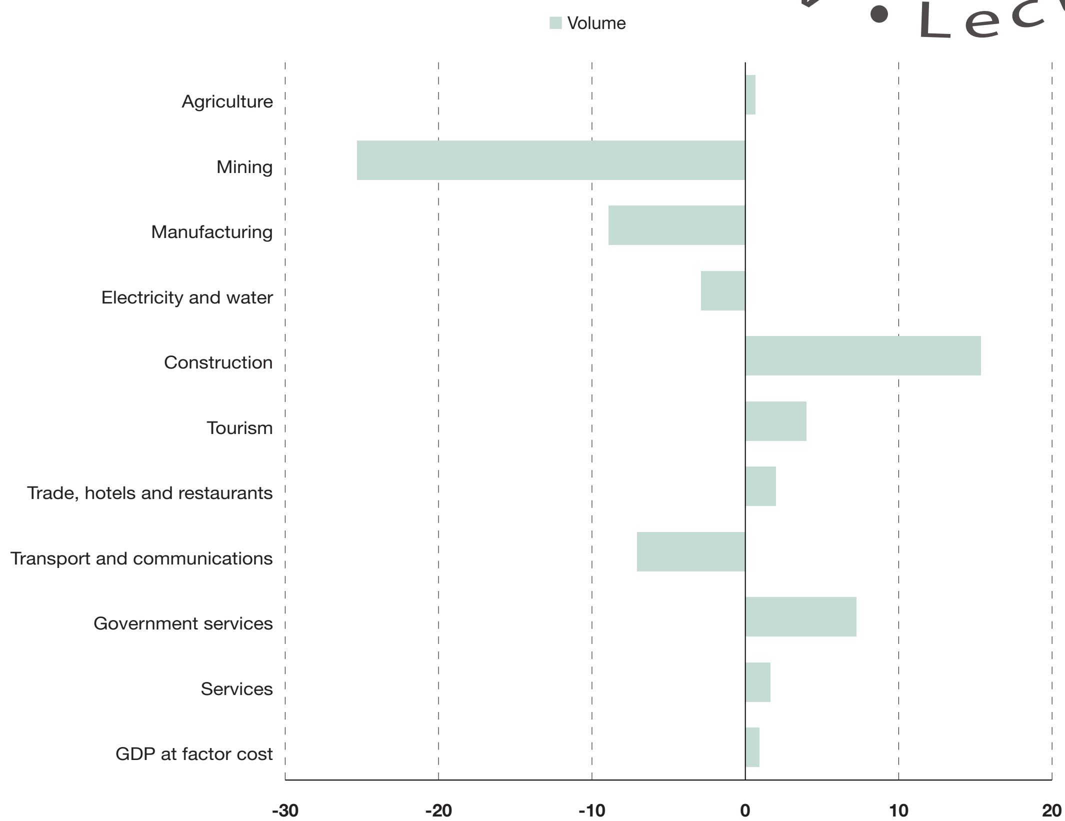
2. The estimation of Rwanda's actual growth for 2004 has been complicated by a long overdue re-evaluation of the time series for agricultural output in the national accounts.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

transport and communications contracted by about 7 per cent. Commerce and tourism, as well as other services, grew moderately. Partly due to statistical revisions in progress, estimates for 2004 indicate a highly uneven picture within the industrial sector, with mining and quarrying growing at over 80 per cent, while the manufacturing of textiles and clothing are estimated to contract by about 25 per cent.

The share of overall consumption in GDP grew by nearly 1 percentage point in 2003, owing to a strong increase in public sector consumption (including public works and public administration), while private consumption remained subdued. Overall, total domestic investment increased from 16.9 per cent of GDP in 2002 to 18.4 per cent in 2003. The overall composition of expenditures is estimated to have remained relatively

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**14.4**	**18.4**	**16.9**	**18.4**	**20.3**	**21.0**	**21.1**
Public	9.3	6.6	4.9	5.6	7.1	7.8	7.8
Private	5.1	11.8	12.0	12.8	13.2	13.2	13.3
Consumption	**105.8**	**97.4**	**100.0**	**100.8**	**99.5**	**99.5**	**99.1**
Public	11.5	11.7	11.8	15.1	15.2	16.5	16.3
Private	94.3	85.8	88.1	85.7	84.3	83.0	82.8
External sector	**-20.2**	**-15.8**	**-16.9**	**-19.3**	**-19.8**	**-20.5**	**-20.3**
Exports	6.0	9.2	7.7	8.3	8.4	8.2	8.3
Imports	-26.2	-25.1	-24.5	-27.6	-28.2	-28.8	-28.6

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

stable from 2003 to 2004, as preliminary results seem to indicate that the government continued to play an active role and the business climate has improved.

Macroeconomic Policies

Fiscal and Monetary Policy

Since emerging from the 1994 genocide, when about one third of the population was killed or displaced, the needs for rebuilding economic infrastructure, government institutions, as well as human capital have been enormous. This resulted in an excess of government expenditures over revenues, mostly financed by a large inflow of grants (amounting to 8.2 per cent of GDP). Yet, the Rwandan government has made important progress in macroeconomic stabilisation, especially by increasing domestic revenues. Tax revenues increased from 10.5 per cent in 2001, to 11.5 per cent in 2002, and to 12.7 per cent in 2003. Tax revenues are expected to remain around this level over the medium term. The relative sharp increase in total revenues from 2002 to 2003 can largely be attributed to tax and structural reforms, including the widening of the VAT coverage and the increase in the VAT rate from 15 per cent to 18 per cent in July 2002, and the re-organisation of Rwanda's tax administration. Furthermore, the government has intensified the systematic collection of arrears and dividends from public enterprises as well as the service of on-lent debt.

Total government expenditure increased from 21.3 per cent of GDP in 2002 to 24.1 per cent of GDP in 2003 which was largely due to a sharp increase in current expenditure. The share of current expenditure

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**16.7**	**19.6**	**19.4**	**21.6**	**25.4**	**25.1**	**25.3**
Tax revenue	8.5	10.5	11.5	12.7	12.5	12.4	12.3
Grants	7.4	8.2	7.2	8.1	12.1	11.8	12.2
Total expenditure and net lending[a]	**22.5**	**20.9**	**21.3**	**24.1**	**25.5**	**27.4**	**27.2**
Current expenditure	13.1	14.2	16.3	18.0	18.2	19.5	19.3
Excluding Interest	*11.5*	*13.4*	*15.3*	*16.8*	*16.8*	*18.3*	*18.1*
Wage and salaries	4.5	5.2	4.9	4.9	4.5	4.6	4.5
Interest	1.6	0.8	1.0	1.2	1.4	1.3	1.2
Capital expenditure	9.3	6.6	4.9	5.6	7.1	7.8	7.8
Primary balance	**-4.2**	**-0.5**	**-0.9**	**-1.3**	**1.3**	**-1.1**	**-0.7**
Overall balance	**-5.8**	**-1.3**	**-1.9**	**-2.5**	**-0.1**	**-2.4**	**-1.9**

a. Only major items are reported.
Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

in GDP increased from 16.3 per cent of GDP in 2002 to 18 per cent of GDP in 2003, while the share of capital expenditure in GDP increased from 4.9 per cent to 5.6 per cent. However, the 2004 estimate for capital expenditure indicates a sharp increase in capital expenditure by about 2.5 percentage points, mostly for poverty reduction measures, financed by grants. Within current expenditures, defence and security expenditure decreased slightly (from 2.9 per cent of GDP in 2002 to 2.7 per cent of GDP in 2003). The wage bill remained constant (at 4.9 per cent of GDP during 2002 and 2003), and is estimated to decrease slightly in 2004. In line with Rwanda's PRSP, the share of current priority expenditure has increased from 6.1 per cent of GDP in 2002 to 6.5 per cent in 2003, and is estimated to increase more sharply to 8.2 per cent in 2004.

The main reason for the increase in current expenditures in 2003 was due to a near doubling of exceptional expenditures from 2.3 per cent of GDP in 2002 to over 4 per cent of GDP in 2003[3]. Including grants, the overall deficit amounted to 2.5 per cent of GDP in 2003 (up slightly from 1.9 per cent of GDP in 2002), and is estimated to decrease to 0.1 per cent of GDP in 2004. Excluding grants, the deficit has increased from 9.1 per cent in 2002, to 10.6 per cent in 2003, and is estimated to increase to about 12.2 per cent in 2004, as sharp increases in poverty-reducing capital expenditures were financed mostly by grants.

Since 1994, Rwanda has adopted far-reaching reforms to make monetary policy more effective, including the rehabilitation of the National Bank of Rwanda (NBR, Rwanda's central bank), the adoption of a new central bank law, and the introduction of indirect monetary policy instruments. Yet, monetary aggregates grew strongly during 2003 as a result of a higher than anticipated financing of the budget deficit by the banking sector and an increase in bank lending to public enterprises and investment projects. Broad money (M2) increased by 15.2 per cent during 2003 and resulted, together with the drought influenced low agricultural output, in an increase in inflation of 7.7 per cent in 2003. The inflation rate reached a maximum of 11.2 per cent in February 2004 and is estimated at about 8 per cent in 2004.

Since 1995, Rwanda has moved towards increasingly market-determined interest rates and exchange rates. Weekly foreign exchange auctions were introduced in January 2001, whereby the NBR offers a predetermined amount of foreign exchange on a marginal price basis and intervenes occasionally to smooth out disturbances. Yet, the fragile health of some commercial banks restricted their participation in the inter-bank, securities, and foreign exchange markets. The government has therefore taken actions to improve the soundness of the banking sector. It sold its majority shares in the Commercial Bank of Rwanda (BCR) to the UK-based Actis Group, and the Continental African Bank of Rwanda (BACAR) to the Kenya-based FINA Bank. It is anticipated that these sales will considerably improve the soundness of Rwanda's banking sector. Rwanda has also enhanced the effectiveness of its central bank and increased its efforts to bring banks into compliance with prudential regulations. The level of official reserves fell from the equivalent of six months of imports in 2002 to five months of imports in 2003, due to a drought-related increase in imports and decrease in exports, as well as delays in the disbursement of about $65 million in budgetary assistance by various donors. Preliminary estimates indicate that the reserves reached the targeted goal of the equivalent of seven months of imports by end-2004.

External Position

Compared to many other developing countries at the same income level, Rwanda's trade regime is relatively open. Rwanda has made progress in reducing the level and dispersion of tariff rates and has no explicit

3. Exceptional expenditures were introduced in 1998 to cover spending on assistance to victims of the genocide, the demobilisation and reintegration of soldiers, civil service reform, education assistance to returning refugees, and the establishment of governance institutions. It is projected that these exceptional expenditures will be reduced to about 1 per cent of GDP by 2007.

non-tariff barriers. Yet, given the large current account deficit excluding official transfers (which increased from 16.6 per cent of GDP in 2002 to 19.2 per cent of GDP in 2003, and is expected to remain at around 19 per cent of GDP over the medium term), Rwanda has intensified actions to increase exports. In August 2004, the cabinet approved a revised export promotion strategy. Actions have also been taken to establish an export-processing zone (EPZ), and negotiations are in progress for Rwanda to join the East African Community (EAC) and the Southern African Development Community (SADC). Rwanda is also initiating a diagnostic trade integration study under the World Bank's Integrated Framework. Based on current trends, Rwanda will continue to depend heavily on foreign assistance. Including transfers, the current account deficit increased from 8.7 per cent of GDP in 2002 to 10.9 per cent of GDP in 2003.

Though total exports of goods decreased from $67.3 million in 2002 to $63 million in 2003, they are estimated to recover in 2004, reaching

Table 3 - **Current Account** (percentage of GDP)

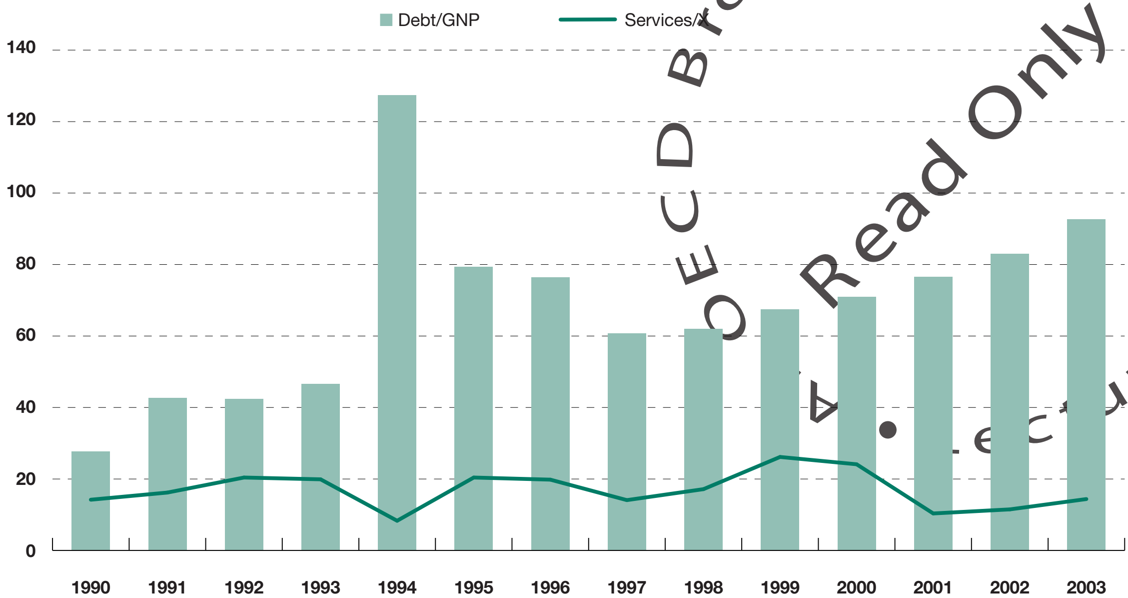
	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-11.3	-8.5	-9.7	-10.8	-11.1	-11.6	-11.3
Exports of goods (f.o.b.)	4.5	5.5	3.9	3.7	4.0	4.0	4.1
Imports of goods (f.o.b.)	-15.8	-14.0	-13.6	-14.5	-15.1	-15.6	-15.4
Services	-10.3	-9.3	-9.2	-10.7			
Factor income	-1.1	-1.3	-1.1	-1.5			
Current transfers	20.9	11.3	11.3	12.1			
Current account balance	**-1.8**	**-7.8**	**-8.7**	**-10.9**			

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

$76.6 million. Exports of tea increased slightly from $22 million in 2002 to $22.5 million in 2003, and are expected to increase to $23.2 million in 2004. Exports of coffee increased slightly from $14.6 million in 2002 to $15 million in 2003, and are projected to increase to $21.1 million in 2004. Due to sharp decreases in world prices of coltan (following the discovery of relative cheap extraction of coltan in Australia), exports of Rwandan coltan continued to decrease from a high of $41.1 million in 2001, to $14 million in 2002, and $6.4 million in 2003. Given the relatively high extraction costs of Rwandan coltan, the recent trend of decreasing coltan exports is expected to continue. Current projections indicate that the extraction of Rwandan coltan will come to an end by 2010. Nevertheless, imports continued to increase from $235 million in 2002 to $244 million in 2003, and are projected to increase to $265 million in 2004. As a result of these developments, Rwanda's trade deficit increased from 9.7 per cent of GDP in 2002 to 10.8 per cent of GDP in 2003. The trade deficit is estimated to hover at around 15 per cent over the next few years.

Owing to the combination of three factors (poor export performance, continued recourse to foreign loans to finance fiscal and external deficits, and falling discount rates) Rwanda's NPV debt-to-export ratio has risen sharply to unsustainable levels, even though Rwanda is currently receiving assistance under the Heavily Indebted Poor Country (HIPC) initiative. Rwanda reached its enhanced decision point in December 2000. At that point, it was estimated that Rwanda would have an NPV debt-to-export ratio of 193 per cent in 2003. The actual level for 2003 however turned out to be 315 per cent. The ratio is expected to worsen during the next few years, reaching a maximum of about 370 per cent in 2005. Negotiations are ongoing to reach the HIPC completion point in 2005; however, it is unclear by how much Rwanda's debt relief may be topped up at the completion point. Rwanda's domestic debt has declined considerably from 16.3 per cent of GDP in 2002 to 5.4 per cent of GDP in 2003, and is

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

– according to the government – expected to be eliminated over the medium term.

Structural Issues

In accordance with the 2002-04 economic reform programme, the government continued to implement key structural reforms targeted at: *a)* the development of the private sector; *b)* a sound and competitive banking sector; *c)* an increased effectiveness and efficiency of the public sector; *d)* improvements in economic governance; and *e)* enhancements in Rwanda's infrastructure. With regards to private sector development, the government has continued to establish a regulatory framework that is more conducive to business, including a revision of the labour code in 2003. With regard to financial sector reforms aimed at increasing the health and competitiveness of the banking sector, the government has sold majority shares in two public banks to foreign investors. In the area of public sector reform, the formulation of an action plan to revamp the public administration was a key achievement in 2003. The action plan is currently being implemented. With regard to governance, a new constitution was adopted in May 2003.

While Rwanda's business environment faces severe constraints because of lack of human capital and structural bottlenecks (including high transportation costs and energy shortages), Rwanda fares relatively well compared with most other sub-Saharan African countries. Based on a 2004 World Bank report[4] assessing the business climate around the world, it takes fewer procedures and fewer days to start a business in Rwanda and to enforce contracts, though the costs of starting a business and of enforcing contracts are slightly higher. Rwanda's business environment is less favourable with regard to: *a)* indices that measure how difficult it is to hire new workers; *b)* how rigid the restrictions are on expanding/contracting the number of working hours; and *c)* how difficult and costly it is to dismiss redundant workers. It is expected that these indicators will improve significantly over the next few years based on the 2003 revision of the labour code.

The government aims at improving the business

4. *Doing Business in 2004: Understanding Regulation*; available on the World Bank website.

environment through ongoing reforms to promote domestic and foreign investment and enhancing the competitiveness of firms. The Rwanda Investment and Export Promotion Agency (RIEPA) has established a "one-stop shop" for investors which has, in collaboration with Rwanda's Private Sector Federation, achieved considerable progress in promoting private investment. The investment code has been refined to cater for export promotion and tax incentives, especially targeted at promoting private investment. The government has also established an Arbitration Centre to deal with commercial disputes. However, the high costs of utilities and transportation remain key constraints for Rwanda's private sector development, especially in the manufacturing sector. These constraints are complicated by the fact that Rwanda is landlocked and very hilly in its natural topography. In 2002, Rwanda also established a National Tender Board (NTB) with the objectives of rationalising public procurement. Although the NTB was able to curb delays and corruption in public procurement, its role and mission have not been clarified due to gaps in the legal and institutional framework governing the procurement system. To improve the public procurement system and enhance the effectiveness of the NTB, the government undertook an initial assessment of the procurement system in April 2004. It is planned that a broader assessment will be completed in 2005, resulting in the formulation of the Country Procurement Assessment Review (CPAR). Yet, it is already clear that the measures taken so far have begun to make significant improvements in the management of public resources by reducing the risk of fraud, embezzlement and corruption.

Following a careful examination of successful privatisation cases worldwide, Rwanda enacted a Privatisation and Public Investment Law in 1996. This Law gave the government powers to liquidate, restructure and divest partially or wholly any public enterprise that was non-performing. Privatisation of public enterprises took effect in 1998, after a total of 90 public enterprises were earmarked for privatisation. As of end-October 2004, 52 enterprises have been privatised, eight enterprises are in the final stages of being privatised, seven have been liquidated, and 23 are yet to be privatised (including the mining company Redemi, the printing and stationary company Imprisco, and the transport company Onatracom). Current efforts concentrate on tourism and telecommunications. In an effort to promote tourism in Rwanda, formerly state-owned hotels, including Hotel Diplomate, Hotel Izuba and Hotel Akagera, are being rehabilitated and face-lifted for privatisation. Regarding the telecommunication industry, Rwandatel and Rwanda-cell have been the key players (in the installation of fixed phones and internet provider, and cellular phones, respectively), although two other telecommunication companies, Afritel and Artel, have also started to operate in Rwanda, especially in the rural areas. The government plans to privatise Rwandatel and to sell off its shares in Rwanda-cell. Of the 40 enterprises that remained state-owned as of end-October 2004, seven were financial institutions. The electricity utility is under a private management contract and a couple of tea factories, previously belonging to one public enterprise, were privatised. Over the medium term, the government aims at privatising the whole tea sector, as well as the whole energy and telecommunication sectors.

The key focus areas of Rwanda's strategy to improve infrastructure are water, energy and roads. The government is undertaking specific projects to increase the supply of clean water in urban areas. It has undertaken measures to improve rural electrification, through the development of micro-plants and/or the extension of the distribution network, including the use of solar energy. Regarding transportation, a basic network of roads exists, especially between Kigali and other major cities, but there are considerable gaps in rural areas that hamper agricultural growth. The improvement of Rwanda's infrastructure is one of the six broad priority action areas of Rwanda's PRSP. The strategy to improve infrastructure includes detailed action plans for: *a)* road transportation; *b)* railway and air travel; *c)* transport and communications at the grassroots level; and *d)* the energy sector.

In addition to Rwanda's central bank, regional credit unions and small private micro-finance institutions, there are seven financial institutions in Rwanda:

- the recently-privatised Banque Commerciale du Rwanda (BCR);
- the recently privatised Banque Continentale Africaine du Rwanda (BACAR);
- three other public commercial banks[5];
- the Union des Banque Populaires (UBPR); and
- Rwanda's publicly-owned insurance agency (Société Nationale d'Assurance, SONARWA).

All banks suffer from a large share of non-performing loans which amounted to 35.6 per cent of their total portfolio at end-March 2004. Due to the fragile situation of Rwanda's banking sector, the government has repeatedly injected funds into public banks. A re-capitalisation of the Rwanda Development Bank (BRD) is planned in 2005. Most banks and credit unions are either failing to comply with Rwandan banking regulations, and/or are exempted from regulatory and tax obligations. While the recent privatisations are expected to improve the efficiency of the banking sector, the overall fragility of the banking sector is likely to remain for some years. Supported by USAID, a new micro-finance project was initiated in June 2003, aiming at increasing micro-finance activities among women's solidarity groups and village banking structure. Within this new project, 86 per cent of the participating micro-finance institutions achieved operational self-sufficiency and 82.5 per cent achieved financial self-sufficiency. Of 1 161 total clients served, 70 per cent are women.

A comprehensive public sector reform was adopted in July 2004. This strategy contains three strategic orientations:

- a review of the role of the state in the context of decentralisation of powers and partnership with the private sector and civil society in general;
- improvements in professionalism of the public sector; and
- the production of a functional analysis of institutions and the development of strategic management tools and systems for the public sector.

The strategies are complemented by a detailed implementation plan. In the area of public finance, the action plan – which has already started to be implemented – calls for: *a)* the adoption of a constitutional law outlining the principles of public finance management and financial instructions for establishing the principles and rules of financial management; *b)* the integration of investment/development budgets; *c)* establishing linkages between the resources allocated to programmes and expected results in terms of public services rendered and/or impact on poverty; *d)* improvement of budgetary execution and control; and *e)* building of capacities for conducting internal and external auditing. The reform also calls for the introduction of a modern information and communication technology (ICT) (including the set up of electronic databases, the use of the intranet and internet, and the automation of integrated management tasks and systems) and a public sector capacity building programme. Finally, to increase the efficiency and accuracy of the national statistical system, the authorities completed in 2003 the legal framework for a new quasi-autonomous National Institute of Statistics.

Based on registration records of Rwanda's Revenue Authority (RRA), there existed about 9 600 small- and medium-sized enterprises (SMEs) in Rwanda in 2002, of which 62 per cent were involved in transport, 19 per cent in retail, 5 per cent in professional services, 4 per cent in importation, and 10 per cent in other sectors. However, there are many small enterprises that are not registered as they are operating in the informal sector. The informal sector is dominated by micro-enterprises. Based on a recent survey, there exist about 70 000 micro- and small-sized-enterprises (MSEs), of which nearly half are active in commerce. In 2002, the Rwandan authorities, in collaboration with the United Nations Industrial Development Organization (UNIDO), created CAPMER, a centre aimed at promoting SMEs in Rwanda. This centre assists SMEs in accessing bank loans, especially from the Rwandan Development Bank (BRD), and by elaborating business plans and feasibility studies. CAPMER and its partners

5. Banque de Kigali (BK), the Banque Rwandaise de Développement (BRD), and Caisse Hypothécaire du Rwanda (CHR).

also provide training in marketing, technology and management for SMEs. A variety of donors have also improved the capacity of rural finance providers through technical and institutional support and training that has helped micro-finance institutions to manage and extend credit and savings mobilisation in the rural sector. Technical assistance provided to the Union des Banques Populaires (UBPR, Rwanda's Credit Union) and to the Rwanda Microfinance Forum, has strengthened these institutions' capacity to effectively manage and track their savings and credit portfolio. To improve the soundness and supervision of micro-finance institutions, and as a first step toward facilitating accessibility, the NBR is currently establishing a database on micro-finance institutions. Besides lack of sufficient access to finance, MSEs also face: *a)* inadequate access and facilities for technical know-how and training; *b)* an absence of innovativeness and new ideas; *c)* a limited access to the formal sector; and *d)* a lack of market development facilities for MSEs.

Political and Social Context

In contrast with the highly-centralised government system prevailing in the past, increasing participation of the people of Rwanda in public life has been encouraged in recent years. Supporting policies and institutions have been established, including a decentralisation policy and the adoption of a new constitution in May 2003. These actions have been followed by a presidential election on 25 August 2003 and legislative elections in September-October 2003. However, there has been some criticism regarding the lack of transparency and tolerance for political opposition[6]. Before the adoption of the new constitution, the government released about 25 200 detainees, mostly persons who had confessed to committing genocide, an action in the spirit of appeasement and national reconciliation. To foster the judicial system, the Ministry of Justice launched in 2003 a nationwide computer network linking the central Ministry of Justice, the Attorney General, provincial prosecutor offices, and the court system.

Regarding regional peace, there was some progress, including the signature in August 2004 of an agreement between the Democratic Republic of Congo (DRC), Rwanda and Uganda to pacify the region with the disarmament of all armed groups operating in the three countries. On 20 November 2004, African leaders from eleven Great Lakes countries also signed the broader Dar es Salaam Declaration, a United Nations backed peace framework for the Great Lakes region. Yet, a few rebel groups have continued operating and temporary fights continue to erupt.

Gender gaps remain important in Rwanda. The Human Development Report (HDR) 2004 of the United Nations Development Programme (UNDP) ranked Rwanda 129 out of 144 countries in terms of the status, treatment and participation of women. Rwanda ranks equally poor in the gender-related development index (GDI), although women's participation in economic and political life is very high in some aspects. For example, Rwanda has, with 45 per cent of seats in parliament held by women, the world's second highest ratio of females in parliament. Female-earned income amounts to 62 per cent of male-earned income. The authorities have been promoting gender equality and the empowerment of women. A Ministry of Gender and Women in Development was created and mandated to spearhead the elimination of gender imbalances in all sectors. In addition, grassroots-based National Women Councils were created. A law on succession and matrimonial regimes was enacted improving the rights of women to property ownership. Besides ratifying the international convention of all forms of discrimination, gender sensitisation campaigns have been ongoing across the country. A National Gender Policy has made gender empowerment and inclusiveness a constitutional requirement. All public sector institutions, beginning with the civil service, must be reviewed in their structures, behaviour and human capital to make them conform to the gender-related provisions of the constitution.

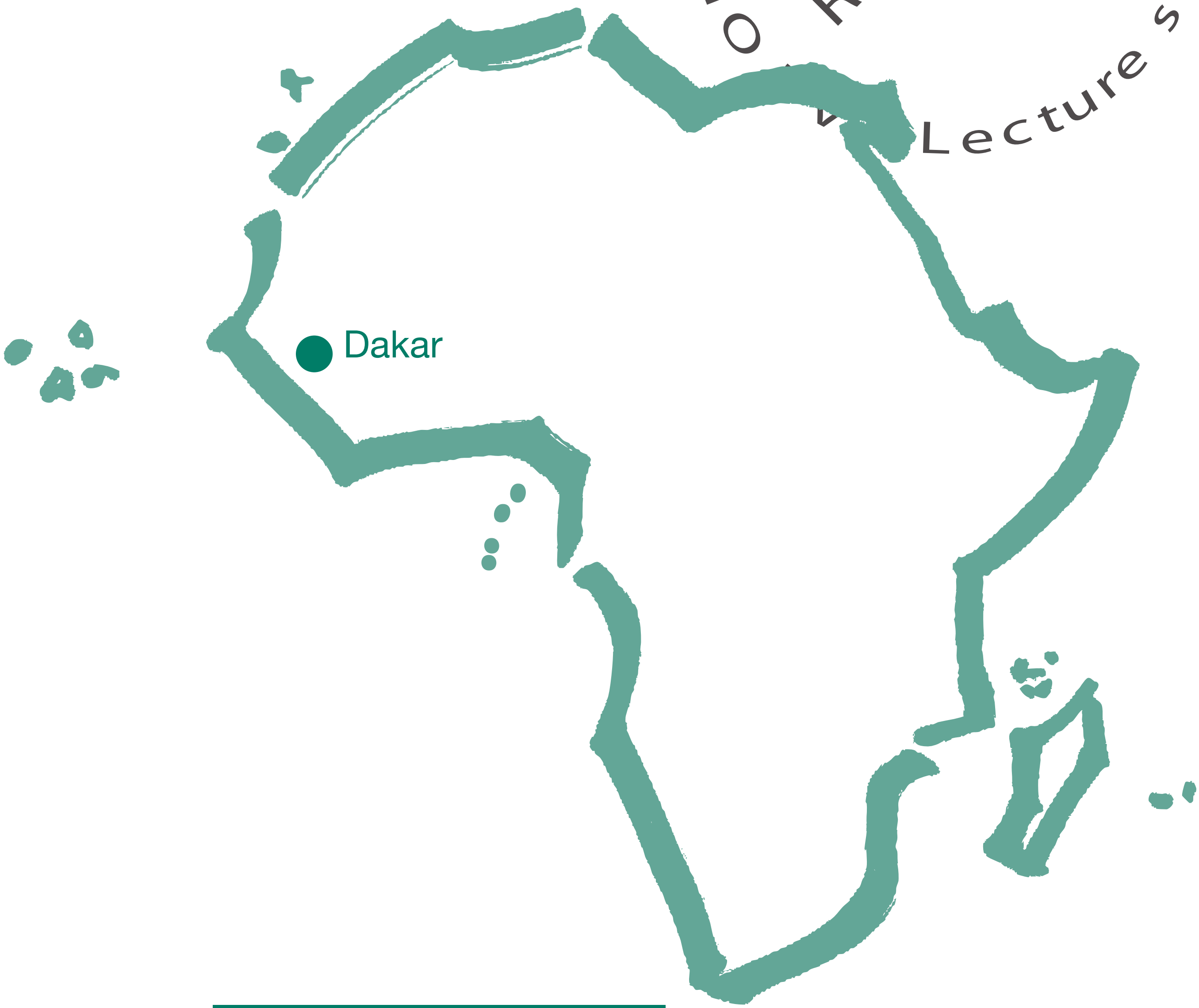
Poverty remains high in Rwanda. Erratic rainfalls

6. See, in particular, US-AID/Rwanda Annual Report FY 2004, dated October 5, 2004.

during 2003 increased the areas in which emergency food supplies were needed to obtain the most basic food security. However, there were a number of improvements in some social indicators, notably in the area of education and health. HIV/AIDS continues to take a heavy toll despite significant efforts – with the support of the donor community – to expand HIV/AIDS services throughout the country. As of end-2003, 34 service centres offered Voluntary Counselling and Testing (VCT) and 39 service centres offered Prevention of Mother to Child Transmission (PMTCT). The total number of orphans due to HIV/AIDS is projected to increase from 264 000 in 2001 to 356 000 in 2010. While health indicators deteriorated sharply in the early 1990s, considerable progress has been made since 1995, though some indicators have not yet reached the levels that were already achieved in 1990. For example, while the under-five mortality rate stood at 141 per 1000 live births in 1990, it rose sharply to 219 during the genocide, and stood at 196 in 2000. After the immunisation campaign was restarted in 1995, reaching a coverage of close to 70 per cent in 1997, it deteriorated owing to lack of supervision and monitoring to less than 50 per cent in 1999. Alarmed by the sudden rise in reported measles, a new campaign and improved monitoring has now resulted in immunisation rates above 70 per cent. The immunisation coverage for DPT3 has been the most successful in recent years, reaching close to 90 per cent in 2003. Yet, malaria remains the major cause of children's mortality, followed by acute respiratory infections and diarrhoeal diseases. Malnutrition and micro-nutrient deficiencies also remain serious problems in Rwanda, even though the rate of severe malnutrition for children under five has been reduced from 29 per cent in 1990 to about 24 per cent in 2000 (which is the latest available data on this indicator). In terms of health policy, a Health Sector Strategic Plan was scheduled to be presented for final adoption in December 2004. The plan is based on a results-oriented medium-term expenditure framework (MTEF), linking planning, costing, and monitoring tools, and integrating the results of planning and costing simulations into the subsequent year's budget. In two provinces, a pilot performance-based payment scheme has been introduced for higher impact services, notably immunisations. The government has also begun to implement micro-insurance schemes (mutuelles); their coverage has increased from 4 per cent of the population in 2002 to about 7 per cent in 2003. Finally, in order to reduce the urban-rural bias in the provision of health services, the government has introduced salary supplements for health workers assigned to remote areas.

With regard to progress made in the education sector, the net primary enrolment rate rose from 73.3 per cent in 2001 to 74.5 per cent in 2002 and 80 per cent in 2003; the number of primary schools increased from 2 143 in 2001 to 2 177 in 2003. With regard to secondary education, enrolment ratios are also increasing, and transition rates from primary to secondary education have shown encouraging improvements, rising from 43 per cent in 2002 to 54.2 per cent in 2003. While the share of girls in primary education is on a par with that of boys, the rate of girls enrolled in secondary schools is, with 48 per cent, slightly below parity. The quality of primary and secondary education remains poor, mainly due to a shortage of qualified teachers, a heavy curriculum, and the lack of appropriate instructional material. While the proportion of qualified primary school teachers has increased from 81.2 per cent in 2002 to 85.2 per cent in 2003, the continued shortage of qualified teachers has led to large classes and a double-shift system. The qualitative problems are reflected in sizeable gaps between enrolment, attendance, and completion rates. Dropout rates were at 14.2 per cent and repetition rates at 32 per cent in 2003. In terms of policies, the Ministry of Education took two major decisions in 2003. First, it eliminated all fees on primary education, and second, it finalised the Education Sector Strategic Plan (ESSP) for 2003–08. The ESSP is a forward-looking, rolling development plan intended to make the education sector policy operational.

Sénégal



key figures

• Land area, thousands of km^2	197
• Population, thousands (2004)	10 339
• GDP per capita, $ (2003)	636
• Life expectancy (2000-2005)	52.9
• Illiteracy rate (2004)	58.9

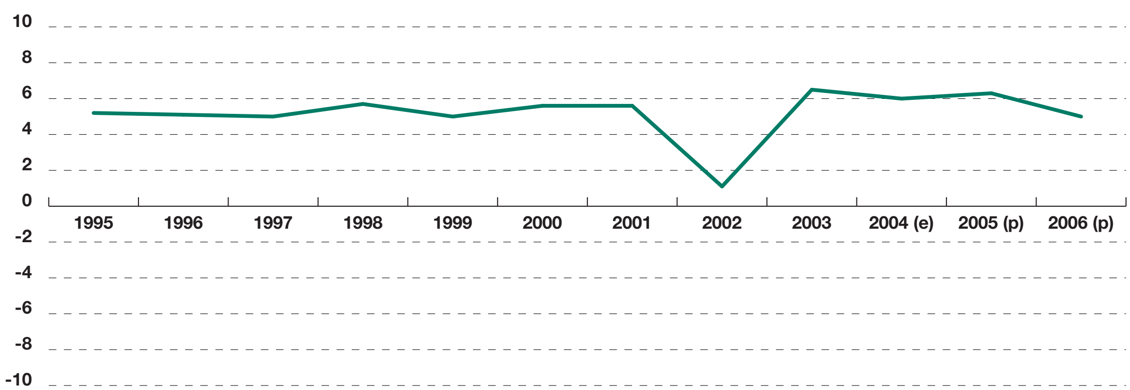
WITH A VIBRANT DEMOCRACY, relatively developed industrial sector and good geographic position, Senegal could replace pre-crisis Côte d'Ivoire as the motor for growth in French Africa.

Following the collapse of agricultural production and a growth rate of just 1.1 per cent in 2002, the country has recovered with two consecutive years of marked economic growth: 6.5 per cent in 2003 and an estimated 6 per cent in 2004. Although partly due to exogenous factors (climatic conditions), this rebound is also explained by the implementation of efficient macroeconomic policies following the economic crisis of 2002. It is encouraging to note that the effects of the crisis were limited, attesting that two developments have enabled the country to absorb large external shocks: space to manoeuvre has been created on the budgetary front – which must be however, used with caution – and a minimum level of economic diversification now exists. In April 2004, the country's financial partners acknowledged its good macroeconomic performance and its efforts on the structural front by announcing that Senegal had reached completion point of the Heavily Indebted Poor Countries (HIPC) Initiative. Recent progress in resolving the Casamance issue is also promising.

Modernisation and diversification of the economy is essential to maintaining strong macroeconomic performance.

Yet the economic, social and institutional challenges faced by the government in order to transform Senegal into an emerging economy are enormous. First, the

Figure 1 - **Real GDP Growth**



Source: *Direction de la prévision et de la statistique* data; estimates (e) and projections (p) based on authors' calculations.

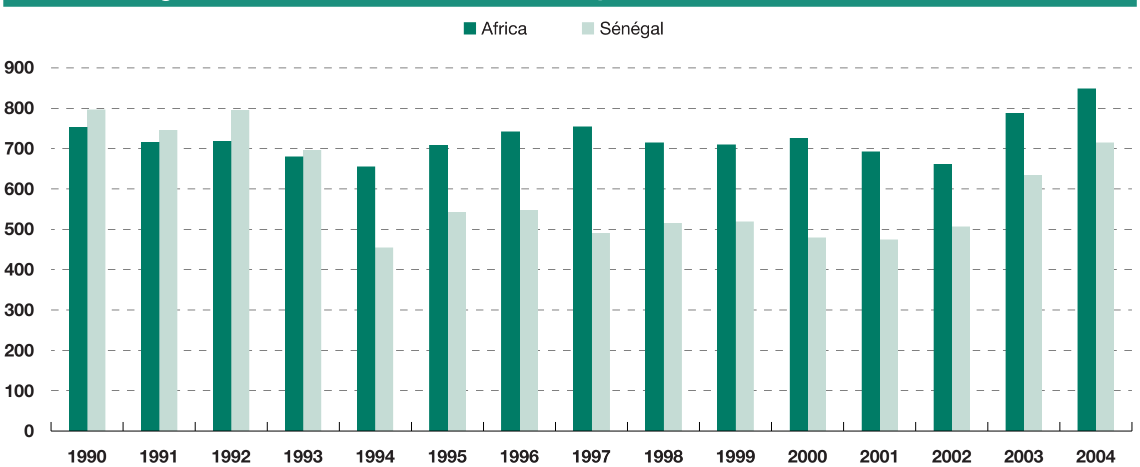
economy must be modernised, diversified and decentralised in order to make it a tool for reducing poverty. This is an industrial challenge, not just in terms of large infrastructure projects, but also in terms of creating a network of small and medium enterprises (SMEs) both in and, particularly, outside Dakar. Foreign investment, with its attendant creation of value added, technology transfer and expertise and job creation, is also essential. The agricultural challenge also consists of modernising the sector and developing non-agricultural activities in rural zones to absorb the "excess" active population resulting from this modernisation. Finally, there is the financial challenge, consisting of putting the Senegalese financial system at the service of domestic production.

Beyond this, it is necessary to improve public policy and to slightly modernise social relations and the institutional environment. It is important to ensure coherence in policies (industrial and agricultural development, macroeconomic management, improving public and private governance, poverty reduction) and, above all, to ensure that implementation is continuously efficient, transparent and stable. Progress could be made in increasing transparency in budgetary management, while frequent changes in ministerial posts do not necessarily encourage continuity in policy implementation. Another major challenge is to modernise social relations in Senegal, specifically by creating a deeply rooted public policy dialogue between public powers, the private sector and civil society. Finally, the institutional environment, whether pertaining to business, the legal system or land reform must be modernised, though this entails difficult social choices (particularly in terms of rural land reform). These various dilemmas, without doubt, will be at the heart of the legislative and presidential election campaigns in 2006 and 2007, respectively.

Recent Economic Developments

While its part in the country's value added was only around 17 per cent in 2003, the primary sector (agricultural, livestock, forestry, fisheries) remains nevertheless a determining factor in the Senegalese economy's health, employing about two-thirds of the active population. In this respect, 2003 was a positive year and the primary sector increased its contribution by 19.8 per cent. Agricultural production alone increased by 36.3 per cent due to an excellent winter rainy season, after having collapsed in 2002 (-32.2 per cent). The 2004/05 harvest took place under less favourable circumstances: overall rainfall in 2004 was largely inferior to that of 2003 and to 1971-2000 averages. In addition, while the threat posed by locusts was contained in the north of the country (Saint Louis, Matam and Louga), saving the country's groundnut production, the crop was nonetheless affected in some regions by pockets of infestation of grasshoppers and caterpillars. The relatively quick reaction by the authorities (who made 5 billion CFA francs, 9.4 million dollars, available in the 2004 budget) combined with international aid, contributed to containing the acridian threat in the country. Given these relatively unfavourable conditions, the provisional results of the 2004/05 harvest can be considered more or less satisfactory. Groundnut production increased by 30 per cent, with expanded cultivation and reinforced seed capital to farmers. Cereal production, however, fell by 21 per cent due to a reduction in cultivation and yields, while cotton production fell by 9 per cent[1]. The good agricultural performances in 2003 and the relatively satisfactory performance in 2004 should not mask the structural problems of the Senegalese primary sector. These include insufficiently diverse agricultural production,

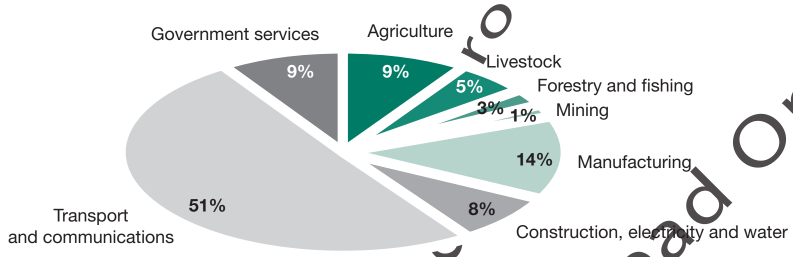
Figure 2 - **GDP Per Capita in Senegal and in Africa** (in current dollars)



Source: FMI.

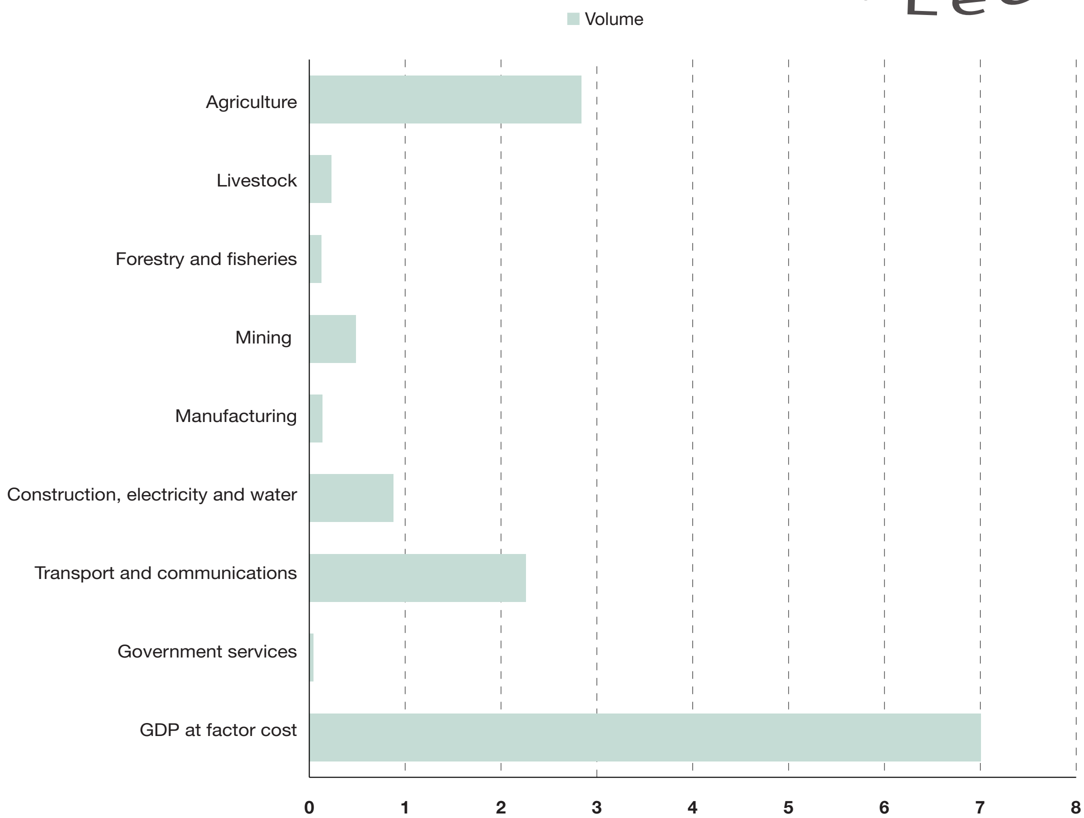
1. The continuous increase in cotton production and yields over the four previous years however, should be noted.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on *Direction de la prévision et de la statistique* data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on *Direction de la prévision et de la statistique* data.

inappropriate land laws lacking any real land rights and land transferability, and soil impoverishment. In May 2004, following an unprecedented consultation with stakeholders, Parliament adopted an agriculture, farming and forestry law (*loi d'orientation agro-sylvo-pastorale*) setting out the basic principles of government action. This aims at reforming family smallholdings and promoting agricultural entrepreneurship, principally by diversifying crops, strengthening technical capabilities, land reform, supporting protection mechanisms against agricultural risk and improving the legal and social position of farmers. It remains to be seen, however, how these goals will be translated onto the legal and budgetary agenda.

On 12 January 2005, at the opening of the court and tribunal sessions, President Wade announced the launch of land reform in the course of 2005. Action should also be taken in fisheries, which suffers from overcapacity and from overindustrialisation (including in traditional fishing) resulting in declining catches and deterioration of the marine ecosystem. However, the rethinking of concession rights for small-scale fishermen and quotas for industrial fishing is progressing very slowly. During the first nine months of 2004, landings were almost stable compared to the first three quarters of 2003, having grown by 5 per cent in 2003.

At the sub-regional level, Senegal is an "industrialised" country, with its secondary sector accounting for about 23 per cent of GDP in 2003, and with more than 30 per cent of exports being manufactured goods. Industrial activity is concentrated in food-processing, construction materials, chemicals and textiles. While the policies of commercial openness, liberalisation and privatisation of the past decade aimed at stimulating the country's industrial development, high factor costs, weak investment and the limited domestic market have hampered the realisation of these goals. The textile sector has difficulty coping in the face of competition from imports of second-hand clothes from Europe and products from Asia. Competition from the latter should become more pronounced with the end of the MultiFibre Agreements on 1 January 2005. Food-processing remains largely dependant on volatile groundnut production, and phosphoric acid production is hampered by unfavourable world prices. The development of machine industries remains embryonic.

The project to construct an assembly unit for high-speed coaches by the Indian company, Tata, which was announced in 2003, is suffering from uncertainty in terms of identifying outlets. Senegalese transporters have been reticent to support the project of renewing the country's high-speed coach fleet, which is backed by the World Bank. After the secondary sector grew by 6.4 per cent in 2003, the industrial index registered 11.4 per cent growth in the first three quarters of 2004. This reflects the strong dynamism of construction materials (+24.5 per cent) and of food-processing (+26.3 per cent) and the revival of phosphoric acid production (+15.5 per cent).

The tertiary sector grew by 4.4 per cent in 2003. During the first three quarters of 2004, this remained positive with the services index, the *Indice du chiffre d'affaires des services* (ICAS), increasing by 20 per cent. In particular, telecommunications grew by 29.3 per cent, reflecting the new dynamism of mobile telephony. The good quality of the telecommunications infrastructure has also enabled a significant increase in call centres over recent years (currently accounting for nearly 2 000 jobs). In the transport sector, the port of Dakar has begun to benefit from the redirecting of goods traffic normally transiting through Côte d'Ivoire. On the other hand, the 2004 tourist season was disappointing. Beyond the unfavourable international

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006 (p)
Gross capital formation	**13.4**	**18.3**	**16.7**	**19.5**	**20.2**	**20.6**	**20.4**
Public	4.6	6.1	8.0	8.5	9.1	9.5	9.1
Private	8.8	12.2	8.8	11.0	11.1	11.1	11.2
Consumption	**92.7**	**91.3**	**93.0**	**92.6**	**91.9**	**92.8**	**92.9**
Public	14.6	14.8	11.2	10.6	11.0	11.2	10.9
Private	78.1	76.5	81.8	82.0	80.9	81.5	81.9
External Sector	**-6.1**	**-9.7**	**-9.8**	**-12.2**	**-12.2**	**-13.4**	**-13.3**
Exports	28.5	30.7	30.5	28.8	28.9	27.7	26.9
Imports	-34.6	-40.4	-40.2	-40.9	-41.1	-41.0	-40.1

Note: The national accounts were revised on the basis of the 1993 national accounting system, published in April 2003.
Source: *Direction de la prévision et de la statistique* data; estimates (e) and projections (p) based on authors' calculations.

outlook, this reflects an ageing tourist infrastructure and inadequate promotion of Senegal as a tourist destination in the face of international competition, notably from the Maghreb.

After growth of 6.5 per cent in 2003, Senegal should register a growth rate of close to 6 per cent in 2004. Private consumption was relatively dynamic (estimated at +5.1 per cent), with demand sustained by increased incomes from the good harvest in the winter of 2003 and by the national programme of public-sector hiring (5 000 new jobs in 2003). Public investment was also a motor for growth in 2004 (estimated at 10 per cent) as, in accordance with the poverty reduction strategy paper (PRSP), social and infrastructure spending strongly increased. Private investment remained dynamic (growth estimated at 5 per cent), principally due to the construction sector. Transfers from the Senegalese diaspora, up strongly since the beginning of the 1990s, reached slightly over 233 billion CFA francs in 2003 (BCEAO figures), or 421 million dollars[2]. These continue to play a key role in demand.

The contribution of the current balance to growth, though structurally negative, was reduced with exports increasing over imports (strengthened by phosphates and re-export of products imported in 2003). A fall in second-hand car imports followed the adoption of more restrictive legislation, as well as a reduction in imports of foodstuffs in the wake of the good 2003/4 harvest. In 2005, growth should remain relatively dynamic with the hiring of 10 000 additional public-sector workers planned for 2004/5, and increased public investment in priority areas. However, the increase in the price of oil could darken the outlook. Though partly mitigated by the rise of CFA franc against the dollar, this will weigh particularly on energy dependent sectors such as chemicals, as well as on household consumption. There is also a risk that the implementation of public spending programmes could be delayed, both in terms of investments and hiring of new public-sector workers.

Macroeconomic Policies

Fiscal and Monetary Policy

In 2003, Senegal conformed to seven of the eight convergence criteria of the West African Economic and Monetary Union (WAEMU). In particular, the level of public debt as a proportion of GDP was 63.3 per cent (WAEMU figures), largely below the average of 70 per cent. Senegal is the only WAEMU country to register a tax burden of above 17 per cent (18.6 per cent). As in previous years, the country has not respected the criteria of maintaining balance in the current account

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006(p)
Total revenue and grants[a]	**20.2**	**19.9**	**20.9**	**21.4**	**21.7**	**21.8**	**21.7**
Tax revenue	15.1	17.3	18.1	18.5	18.6	18.6	18.7
Grants	4.2	1.8	1.8	2.1	2.1	2.3	2.2
Total expenditure and net lending[a]	**20.3**	**21.9**	**21.0**	**22.8**	**24.0**	**24.5**	**23.7**
Current expenditure	12.8	15.6	13.2	13.9	14.2	14.2	13.8
Excluding Interest	*10.5*	*14.7*	*12.1*	*12.7*	*13.1*	*13.2*	*12.9*
Wages and salaries	6.6	5.3	5.7	5.5	5.6	5.7	5.5
Interest	2.3	0.9	1.1	1.2	1.2	1.0	0.9
Capital expenditure	7.5	6.5	7.9	9.1	9.7	10.1	9.7
Primary balance	**2.2**	**-1.1**	**1.0**	**-0.2**	**-1.2**	**-1.7**	**-1.1**
Overall balance	**-0.1**	**-2.1**	**-0.1**	**-1.4**	**-2.4**	**-2.7**	**-2.0**

a. Only major items are reported.

Source: *Direction de la prévision et de la statistique* data; estimates (e) and projections (p) based on authors' calculations.

2. These figures, however, measure informal transfers very imperfectly.

excluding grants. The current account deficit is approaching 8.6 per cent of GDP (WAEMU figures), well above the average of 5 per cent. In 2004, the good performance of inflation and the satisfactory implementation of the state budget should permit Senegal to fulfil the same seven criteria.

In 2003, the overall budgetary deficit (including grants) reached 1.4 per cent of GDP, compared to 0.1 per cent in 2002. This relative deterioration reflects a rise in priority spending (in compliance with the PRSP goals) specifically, investments in health, education and infrastructure. Furthermore, the authorities hoped to give a boost to the economy to limit the effects of the poor 2002/3 harvest (via an emergency agricultural aid programme adopted in August 2003). The implementation of the 2004 budget took place smoothly.

In the context of ongoing budgetary discipline, the budget aimed to continue increasing spending in the priority areas identified by the PRSP and to increase capital spending. Capital spending was estimated to have increased by 10 per cent in 2004. This rise was attributable both to the fact that structural reform programme expenses initially scheduled for 2003 were carried over to the following year, and to a higher wage bill (partly attributable to the ongoing programme of recruiting 15 000 public service workers between 2003 and 2005) and it was expected to lead to an estimated overall budget deficit (including grants) of 2.9 per cent. This goal seems to have been attained, as the overall deficit for 2004 is estimated at 2.4 per cent. At the end the first quarter 2004, half of income anticipated in the budget (particularly, taxes) had been collected. Corporate tax revenue, in particular, strongly increased (+28 per cent). The introduction of a universal company tax (*contribution globale unique* CGU) did not negatively affect revenue, as the widened fiscal base compensated for the lowering of the tax rate, from 35 to 33 per cent.

Caution seems to prevail in spending. At the end of the first semester of 2004, almost half of current spending scheduled in the budget had been committed. By mid-2004 however, only 38 per cent of the year's capital expenditure had been disbursed (though public procurement procedures require that the good execution of investment expenses is considered only at the end of the fiscal year). Additional funds had to be spent to contain the locust invasion. These were included in the interim budget adopted on 25 October 2004: 3 billion CFA francs (5.7 million dollars) was committed to combating the acridian threat and 2 billion CFA francs (3.8 million dollars) to endow an agricultural disaster fund. Likewise, the expenses from investments in Thiès for the Independence celebrations in April 2004 (some of which were made outside regular budgetary procedures, see below), had to be budgeted retroactively in the interim budget. This also envisaged spending in priority sectors, specifically targeting the agricultural population, transport and education. These additional expenses are covered by 41 billion CFA francs (77.5 million dollars), of which 31.5 billion CFA francs is HIPC Initiative discharges obtained for 2004.

The 2005 budget should be coherent with the previous year, maintaining focus on the priority sectors of education and health (50 per cent of running costs) and agriculture and infrastructure (45 per cent of investment expenditure). The infrastructure construction goals proclaimed by the government, particularly that of improving urban mobility in Dakar, should lead to a budget deficit (including grants) of nearly 2.7 per cent of GDP, one point above the rate initially agreed with the IMF.

On completion of the first review of the three-year poverty reduction and growth facility (PRGF) initiated at the beginning of 2003, Senegal's fiscal discipline and adherence to nearly all performance indicators enabled it to obtain the disbursement of a second instalment of 5.2 million dollars in February 2004. A second review, scheduled for June 2004, had to be postponed due to lack of progress in privatising the national groundnut marketing company, SONACOS (*Société nationale de commercialisation des oléagineux du Sénégal*) (and until the bid was finally won by Advens in December 2004). The concerns about fiscal transparency expressed by the IMF due to irregularities noted following Independence festivities[3], also came into play. This review should eventually take place in the beginning of 2005. Good fiscal performances, however, should not mask structural weaknesses in public finances. While the last budgets reflect increased spending power in PRSP priority sectors, their sectoral budgetary allocation remains inadequate.

To remedy this, the 2005 budget will incorporate working plans for each sector, specifically regarding public investment. Executing public spending, particularly investment budgets, could also prove difficult if this involves external funding sources. The review of public investments made in 2002 revealed that the execution rate was below 73 per cent, while the examination of HIPC Initiative spending for 2003 pointed out that in mid-2004 almost 13.7 billion of a total 45.2 billion CFA francs (85.4 million dollars) available had yet to be committed. The execution rates for education and health were particularly weak (57 per cent). For these reasons, improving the chain of public spending must become a government priority. In this respect, the Senegalese government has promised to implement two action plans supported by the World Bank and the European Union. Their priorities are medium-term budgetary planning oriented towards following up on results, devolving and simplifying public spending channels, increasing transparency, improving control (particularly external) of budgetary execution and improving public procurement procedures.

As a member of the franc zone, Senegal's monetary policy is conducted by the West African Central Bank (BCEAO). The pegging to the French franc, and then to the euro – which resulted in mild inflation between WAEMU and the euro zone – led the BCEAO to adopt a rates policy largely aligned with that of the European Central Bank. In March 2004, BCEAO discount and special purchase and resale agreement (SPRA) rates went from 5 per cent to 4.5 per cent and from 4.5 per cent to 4 per cent, respectively. The good 2003/4 harvest and a strong euro resulted in consumer prices remaining stable in 2003 and rising slightly in 2004 (0.5 per cent). The strong rise in the price of oil, partly mitigated by the weakness of the dollar against the euro, had a restrained effect on the price index: in 2004, the transport index rose only 2.6 per cent over the previous year. Still, its development in 2005 remains uncertain: increases in the euro/dollar parity and the price of oil will once again be determinant. In 2005, excluding the possibility of an oil price shock (with the price per barrel remaining around 45 dollars), inflation could be around 2.1 per cent. Domestic credit increased by 3.4 per cent between September 2003 and September 2004, of which 7 per cent was credit to the economy.

External Position

Senegal's trade balance has been structurally negative since Independence. In 2003, the trade deficit deepened slightly over the previous year, going from 10.3 to 11.1 per cent of GDP. The country's external position in terms of trade in services was also negative in 2003 (contrary to 2002), thus increasing the current account deficit.

Exports fell between 2002 and 2003, from 661 billion to 657 billion CFA francs (1.25 to 1.24 billion dollars). Fishing exports, a key sector, on average accounting for one-quarter of exports, fell from 182 to 164 billion CFA francs during the same period. Exports of phosphates and phosphoric acid, more or less dynamic until 2003, significantly contracted, from 133 to 86 billion CFA francs. In 2003, the value of Senegalese exports to West Africa surpassed that of exports to the European Union for the first time, although European imports remained three times higher than those from the sub-region. India, which purchases almost all of Senegal's phosphoric acid, remains the country's biggest client. The mild contraction in exports was accompanied by a growth of imports from 1 364 billion to 1 370 billion CFA francs (from 2.58 to 2.59 billion dollars) between 2002 and 2003. This progression is partly due to the strong growth in value

3. In 2003, without Parliamentary approval, the government contracted entrepreneurs to undertake work for the Independence celebrations in Thiès with promises of payment against future budget resources. Letters of assurance were also given to these entrepreneurs in order to obtain bank loans.

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-5.8	-9.3	-10.3	-11.1	-11.0	-12.1	-11.9
Exports of goods (f.o.b.)	20.6	22.0	21.8	20.5	21.0	20.1	19.5
Imports of goods (f.o.b.)	-26.4	-31.3	-32.2	-31.6	-32.0	-32.1	-31.3
Services	-0.4	-0.3	0.6	-1.0			
Factor income	-1.5	-1.9	-3.0	-1.6			
Current transfers	3.5	6.7	7.0	7.1			
Current account balance	**-4.2**	**-4.9**	**-5.7**	**-6.7**			

Source: *Direction de la prévision et de la statistique* data; estimates (e) and projections (p) based on authors' calculations.

of petroleum imports (24.7 per cent over the period), linked to the rise in world oil prices begun in 2003.

During the first three quarters of 2004, Senegal's trade deficit reached 744.5 billion CFA francs (1.4 billion dollars). This figure is slightly down from the same period in 2003, when the deficit was 688.5 billion CFA francs (1.3 billion dollars). The trade deficit should remain at around 11 per cent of GDP throughout 2004. Of the largest exports, phosphoric acid, petroleum products and cotton grew quite vigorously in the first three quarters of 2004, while exports of unrefined oil and fertiliser were below their 2003 levels. The decline in value of rice, oil and sugar purchases during the first three quarters of 2003 was not sufficient to offset the rise in value of crude oil, wheat and manufactured goods.

Being a large exporter of petroleum products, the net impact of the rise in the price of oil on Senegal's balance of trade in 2004 and 2005 will depend on the relative evolution of the barrel price of oil, the price of petroleum products and the CFA franc/dollar exchange rate.

The process of regional negotiations of the Economic Partnership Agreements (EPA) with the EU, launched with the Economic Community Of West African States (ECOWAS) in October 2003, have led to concerns in several sectors of the Senegalese economy about future competition from European imports. At the same time, the process is leading to the implementation of large-scale aid to Senegalese producers from aid bodies (EU, *Agence française de développement*, etc.), targeting improving the business environment or modernising companies.

Transfers from overseas Senegalese were measured (with the usual imprecision and underestimation associated with these statistics) at 233 billion CFA francs (421 million dollars) in 2003. Representing 6 per cent of GDP (BCEAO figures), this figure has risen strongly since 1999 (when it was 47 billion CFA francs or 88.8 million dollars).

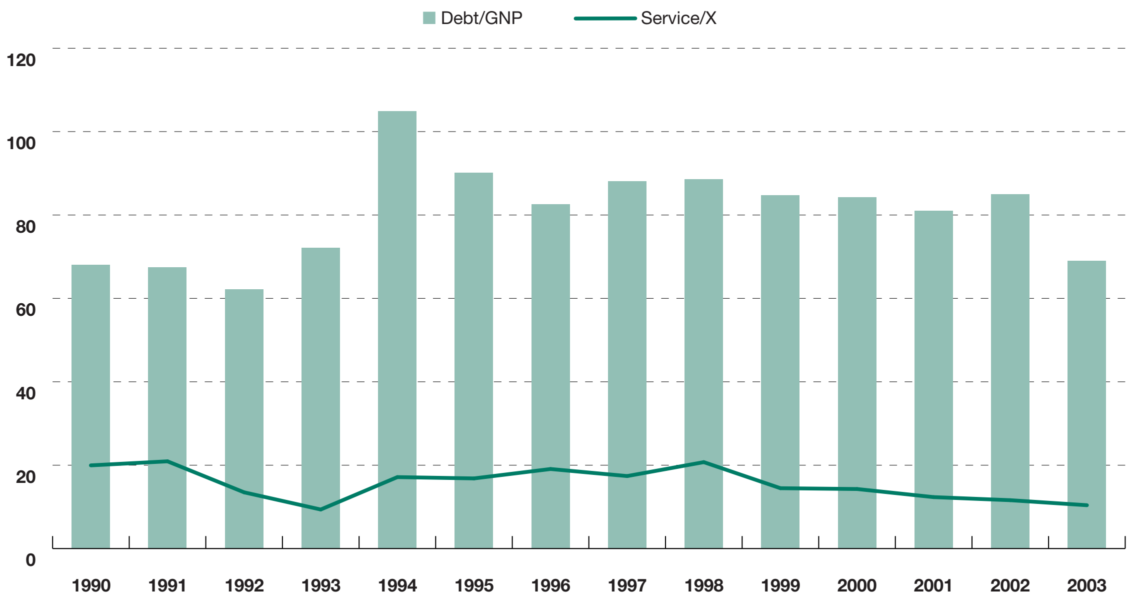
Public Development Aid (PDA), an equally important external flow for Senegal, also rose massively. In 2003, PDA reached 450 million dollars, or 44.7 dollars per inhabitant, compared to an average of 34 dollars in all sub-Saharan Africa. While the country's financial and technical partners continue to demonstrate their confidence in the Senegalese authorities – underlined by the country reaching the HIPC Initiative completion point – there are reservations regarding the country's capacity to absorb this foreign aid and some have highlighted some programmes' low absorption rate. Discussions are thus underway between the Finance Ministry and the funding bodies to harmonise and simplify these programmes' procedures and to better co-ordinate their actions. Certain aid donors, including the EU, are supporting the strengthening of capabilities to manage and absorb aid.

Senegal's external debt is primarily multilateral (67.5 per cent of the total) and was estimated at 2 083.6 billion CFA francs (3.94 billion dollars) at the end of September 2004. This is about 56 per cent of nominal GDP in 2003 (and 52 per cent of estimated GDP for 2004). This should be significantly reduced with the attainment of the HIPC Initiative completion point on 19 April 2004. Within the framework of this initiative, Senegal is beginning to benefit from a nominal 850 million-dollar debt discharge (including interim discharges conceded since the decision point in 1998). This will reduce the Senegalese debt below HIPC Initiative levels, both in terms of the debt (in 1998 net present value) to export ratio (down to 143.9 per cent) and the income to debt ratio (down to 194.3 per cent). This compares to respective ratios of 165 and 310 per cent at the end of 1998. However, as export revenues were less than forecast at decision point, the export to debt ratio remained high at completion point. Partly for this reason, on 9 June 2004 the Paris Club creditors decided to forgive an additional 336 million dollars (1998 NPV). Following this, the debt to export and debt to revenue ratios should be reduced to 116 and 157 per cent, respectively. Senegal's position coming out of the HIPC Initiative thus appears to be both healthy and relatively comfortable, and it should even be sustainable if export revenue or growth shocks occur. The country should nevertheless undertake to borrow on concessionary conditions.

Structural Issues

A large proportion of the structural limitations of

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of export)



Source: World Bank.

the Senegalese economy are linked to the business environment. Two types of factors – infrastructural and institutional –contribute to this. In terms of infrastructure, production costs and transportation costs particularly are as high throughout the country as in Dakar. Moving goods and people is difficult, costly and slow. This factor notably has prevented Senegal from fully profiting from the crisis in Côte d'Ivoire by becoming an alternative export route for goods previously transiting the port of Abidjan. The gridlock and inadequacy of the Dakar road infrastructure also contributes to reducing its attractiveness to investors.

There is near consensus between funding bodies and the government regarding the necessity of resolving the problem of urban mobility in the perimeter around Dakar. The government has taken some action, the most visible of which was to buy a fleet of second-hand buses several years ago. These are now the most common form of transportation in the capital. In partnership with several funding agencies, including the World Bank, the *Agence française de développement* (AFD) and the Nordic Development Fund (NDF), the government has initiated an urban transportation improvement project (*Projet* *d'amélioration de la mobilité urbaine*, PAMU) in Dakar. Costing 103 million dollars, this provides for, among other measures, the renovation of the city's roads and suburban railroad lines, the creation of a system of commercial credit for small urban transport operators, application of anti-pollution measures and the launch of studies into building relief roads. The 2005 budget included other measures, such as installing traffic lights at central crossroads in the capital.

Measures to be taken in Dakar and the surrounding area go hand in hand with projects to improve the national transport infrastructure. These notably include a project (*Projet sectoriel transport 2*, Pst-2) managed in partnership with the World Bank, AFD, NDF and the African Development Fund[4] (ADF, part of the African Development Bank), involving a total of 581 million dollars. The Pst-2 provides for the renovation and improvement of the road infrastructure, the modernising of rail (privatisation of the Dakar-Bamako line), air and maritime transport, as well as planning and financial management reforms of the sector. A complementary initiative is the construction of a so-called "millennium" project at Diamniadio (approximately 35 kilometres from Dakar). This aims at creating a new urban growth centre other than Dakar. In the first phase of the project, the government is undertaking to buy land and to lay it out as a multifunction urban centre so that – in the second phase – companies can be attracted to the area. Senegal requested 548 million dollars (of a total cost of 696 million dollars) in financing from the Millennium Challenge Account (MCA), a competitive foreign aid programme created by the United States. Of the hundred of so countries interested in the MCA, Senegal was one of only 16 deemed eligible for support on the basis of criteria of good governance, progress in health and education and economic management (particularly in terms of support for the private sector). The Diamniadio project was chosen as a finalist by the MCA, which is a very encouraging sign.

Less tangible and more difficult to reform, the institutional infrastructure also conditions the business environment. The International Finance Corporation (IFC) of the World Bank provides several quantitative and qualitative indicators on the subject. These include a measurement of the difficulties to create and launch a new company and hire or fire employees, rules regarding property transfers, protection for investors and bankruptcy resolutions. In the majority of cases, Senegal is very close to, or slightly above the average for sub-Saharan African countries. This mixed result gave rise to a meeting between national and foreign economic actors, which took place under the framework of the Presidential Investment Council. Their meeting brought about a number of recommendations, some of which have been at least partially followed through: reform of the mining and environmental codes, creation of a national commission to combat non-transparency, corruption and misappropriation of public funds, land reform, adoption of a new general tax code and complementary fiscal measures, changes to the legal framework of privately-funded infrastructure projects, launch of the PAMU mentioned earlier and, perhaps most important, adoption of a new investment code in February 2004.

In spite of these initiatives, the national body for promoting investment and public works (*Agence nationale chargée de la promotion de l'investissement et des grands travaux*, APIX) recorded a fall in regulatory approvals of new investments in 2004. This can be explained by the uncertainty that surrounded the adoption of the new investment code, which encouraged investors to postpone their activities. Moreover, the completion rate of authorised projects is comparatively low, estimated at just 46 per cent. APIX had noted, however, a qualitative increase in authorised investments in non-traditional and possibly more dynamic sectors (such as telecommunications).

Senegalese companies generally complain about backlog in the legal system in dealing with commercial and labour code matters. In this respect, neither the introduction of an extra-judicial means of conflict resolution nor the creation of an arbitration council led to the anticipated interest or the expected results. Moreover, on the commercial front, the implementation, transparency and permanence of the courts' decisions

4. AFD financing is around 61 million dollars, of which 23 million alone is for the Diamniadio-Mbour road.

are often problematic. Recent high-profile disputes regarding foreign companies in Senegal (such as the *Société Générale de banques au Sénégal* – SGBS) recently brought these problems to light.

Among other structural problems, access to land has also been highlighted. This is clearly a major challenge in the agricultural sector: farmers' difficulties in obtaining recognition of their property rights prevents them from using their land as collateral for loans, the corollary of which is low agricultural investment. However, it must be pointed out that the low market value of land in rural areas makes it difficult to use as collateral. In manufacturing and services, access to real estate is equally problematic, with similar consequences in terms of obtaining mortgages. In 2002, the government established an industrial support organisation (*Agence d'aménagement et de promotion des sites industriels*, APROSI), which aims at opening new industrial parks to house companies. This strategy seems to work well, but the existing parks are already full and those companies on industrial park land are seeking to expand. The Diamniadio project will help to make up for this deficiency. It would appear, however, that the demand for property seems to have enduringly surpassed supply.

Privatisation in Senegal has been confined to the ongoing sales of the national electricity producer (SENELEC) and of SONACOS. In the past, the privatisation of these two companies was closely scrutinised but it has proved very difficult to manage. The World Bank and the IMF both insist on the sale of these two companies. The privatisation of SONACOS in particular was among the completion requirements of the HIPC Initiative and the IMF listed it in the criteria of PRSP implementation in April 2003. SENELEC has already been the subject of two unsuccessful privatisation attempts in the last few years, notably due to the poor state of its production machinery and distribution infrastructures. As a result, the government is henceforth focusing on improving the company and increasing its production capacities. As part of this, reforms such as the replacement of the management team in September 2003, the restoration of accounts and the announcement of new construction projects of production facilities with new partners such as Mitsubishi (on the technical front), have been well received by funding agencies. Uncertainty remains though about the government's intention of passing on the rise in oil prices to that of electricity, and on how this will affect SENELEC's accounts. The privatisation unit of the Finance Ministry is considering another attempt to privatise the company once a new power station has been connected to the network at the beginning of 2006. After long and difficult negotiations, on 22 December 2004 Advens became the acting winner of the SONACOS tender, by taking over 66.9 per cent of the shares held by the state. The question of whether or not the country will revive a high-technology oilseed industry remains unanswered however, as returns are on a downward trajectory in this sector.

Apart from SENELEC and SONACOS, the list of public companies initially earmarked for privatisation in the 1995 privatisation act, is now comprised of three firms, which are scheduled for sale in 2005: the Senegalese national lottery (LONASE), the centre for infrastructure research and studies (*Centre expérimental de recherches et d'études pour l'équipement*, CEREEQ) and the international centre for foreign trade (*Centre international du commerce extérieur du Sénégal*, CICES).

Despite their key role in the Senegalese economy (particularly in the tertiary sector), SMEs face big challenges in growing, investing, innovation or even, more simply, in managing their finances or meeting their tax obligations (once they are in the formal sector)[5]. The problems SMEs confront regarding financing, particularly in obtaining medium-to-long-term loans of amounts falling between microfinance (20-30 million CFA francs or 40 000-60 000 dollars) and bank loans

5. No official single definition of an SME exists in Senegal: in addition, many operate in the informal sector, which contributes to making them difficult to survey. The country's investment code, for example, defines an SME as a company investing between 5 and 200 million CFA francs that enables the creation of at least three permanent Senegalese jobs. By compiling the different available sources however, SMEs account for around 90 per cent of formal Senegalese companies, 20 per cent of value added produced in the country and 30 per cent of jobs in the modern sector.

(above 100-200 million CFA francs or 200 000-400 000 dollars) contributes to explaining this situation.

These difficulties are compounded by the problems faced by SMEs in many African countries: reluctance by the banking sector to finance "unbankable" and often "opportunistic" projects; financially weak companies (lacking private funding and guaranties, and inadequate initial outlay); problematic legal and business environment (despite the harmonisation of national legislation with OHADA[6] measures), particularly in terms of compiling and exercising guarantees and land securities, of mortgage and property law (absence of a mortgage market, co-existence of modern and customary land systems, weak land values) and of enforcing contracts (inefficient commercial judiciary). Nervousness on the part of banks could also be explained by the strict prudential environment necessary for juggling the risk systemic in WAEMU: the coefficient of the coverage of medium- and long-term jobs by stable resources set out by the BCEAO also highly constrains the transformation of short-term resources into medium-to-long-term loans, and thus the role of the banking sector as financial intermediary. In fact, Senegalese banks are highly liquid, though this is primarily in short-term resources. Furthermore, almost no alternatives to bank loans (such as risk capital) exist for middling sums.

The principal initiatives of the Senegalese authorities and international funding bodies focus upstream on consolidating the SME sector and, more directly, easing their access to financing. On the one hand, the creation of an SME minister in 2001 marked the beginning of a process of unifying and simplifying the institutional framework in which SMEs operate. The chief measures

Growth Possibilities of Micro-finance in Senegal

Senegal has the most vibrant micro-finance sector in the WAEMU zone. The country accounts for 21 per cent of the zone's micro-credit activity, and between 2000 and March 2004, the number of decentralised financial institutions (DFIs) in Senegal regularly providing financial information, grew from 121 to 305. At the same time, micro-credit activity increased three times faster than bank credit to the economy. Senegalese micro-credit also differs from others: *i)* by its relative concentration, as the three leading networks – CMS (*Crédit mutuel du Sénégal*), PAMECAS (*Programme d'appui aux mutuelles d'épargne et de crédit du Sénégal*) and ACEP (*Alliance de crédit pour la production*) – alone account for two-thirds of the client base, 75 per cent of deposits and 78 per cent of loans in the sector; and *ii)* by its financial soundness – the ratio of non-performing loans in the principal networks is low (2.9 per cent in March 2004). This situation is encouraging: the large micro-finance networks would appear to be in a position (and have already begun) to "grow with their customers" and to move from micro- to meso-finance, while benefiting from experience gained with their micro-enterprise clientele. Some of these organisations envisage creating specialist SME banks. To enable this development, the sector needs to consolidate further, and the supervision of the sector must be strengthened and legislation harmonised to allow banks to engage in micro-finance activities on the same favourable terms granted to micro-finance organisations.

More generally, the financing difficulties faced by SMEs reflect the lack of depth in the Senegalese financial and banking system. Bank loans granted to the private sector were only 21 per cent of GDP at the end of 2003. In March 2004, the twelve banks[7] and three financial institutions in the Senegalese financial sector were reasonably robust, with a net non-performing debt ratio of 4.4 per cent and risk-to-reserves ratio of above 8 per cent for ten of the twelve banks, and slightly below this for the remaining two. The strong exposure of the banking sector to the booming Dakar property sector must, however, be closely watched.

6. *Organisation pour l'harmonisation du droit des affaires en Afrique.*

7. The Sahel-Saharan Bank began operations in 2004.

included instituting a single definition of an SME, which should be adopted shortly, and putting in place tools to survey companies and evaluate the support they receive, in addition to simplifying the tax system and procedures for establishing collateral. The general thrust of these was confirmed by the adoption in 2003 of an SME charter, which should lead to a vote in 2005 on an act to promote and develop SMEs in Senegal. These texts equally provide for SME-specific access to public markets and to public service concessions. Funding bodies such as the AFD, for example, are concentrating on improving SME capabilities even prior to the financing request (strengthening the management and quality of information systems, financial transparency, better formulated financing requests, etc).

In terms of access to actual financing, the initiatives aim at setting up new lines of soft loans provided for in the SME charter, and on perpetuating existing measures such as the economic promotion fund (*Fonds de promotion économique*, FPE) that unites a refinancing fund and a guarantee fund for financial institutions lending to SMEs. The private-sector support programme (*Programme d'appui au secteur privé*), which brings together several funding agencies (the African Development Bank, in particular), contains several measures pertaining to the reform and financial improvement of the FPE. Specifically, it aims to make the FPE a financing instrument for SMEs by diversifying the financial products available to them (for example, by using the savings of Senegalese immigrants). Certain funding bodies are also exploring accompanying the banking sector in studying and financing the SME sector (this includes for example, the Africa Project Development Facility, an initiative of the SFI). Lastly, the growing amounts lent by the local micro-finance sector, which is among the best structured in the region, is also worth exploring in the efforts to replace the SME link missing in the Senegalese financial system. In spite of progress, micro-credit accounts for only 5 per cent of bank loans (see box).

Political and Social Context

The organisation of legislative elections in 2006, followed by the presidential elections in 2007, which could see the current president, M. Abdoulaye Wade seek a second mandate, increasingly influence Senegalese political life. This is contributing to straining relations between the government and opposition and to creating a campaign atmosphere. Despite this polarisation, the opposition has not set out a clear alternative, being weak and divided by numerous defections to the *Parti démocratique sénégalais* (PDS), supporters of the president of the republic. In April 2004, Idrissa Seck was replaced by Macky Sall as the head of government. This was the fourth prime minister appointed since President Wade was elected in April 2000.

The arrest of the journalist Madiambal Diagne, director of *Quotidien*, in July 2004 had important international repercussions. Mr. Diagne, who had published articles denouncing corruption by customs officials, refused to name his sources. His arrest provoked a strong outcry in Senegalese and international media. The matter reached a peak during President Wade's July visit to Paris when the French president, Jacques Chirac mentioned the "Diagne" case. The Senegalese president committed himself to repealing the law authorising the journalist's detention, reminding others that he himself had been imprisoned under it when he was in opposition. While Mr. Diagne has been freed, the charges against him have not been dropped. In January 2005, the Ezzan law was adopted granting amnesty for political offences committed during election periods since 1983. This law, which applies to the assassins of Mr. Babacar Seye, the president of the constitutional council in 1993, was the subject of great controversy in Senegal.

The resolution of the long conflict in Casamance advanced significantly with the 30 December 2004 signing at Ziguinchor of a peace agreement between the government and the MFDC (*Mouvement des force démocratiques de Casamance*). The two parties agreed to cease hostilities immediately and to undertake negotiations specifically aimed at demobilising and reinserting the rebel combatants into society, as well as mine clearing and rebuilding Casamance. Economic and social activities will also be restarted in the region. Eighty billion CFA francs (151 million dollars) was earmarked to this effect.

Discussions about social progress in the country currently focus on the design and the revision of the PRSP, adopted in April 2002 and approved by the IMF and the World Bank in December 2002. Under this, the government committed almost half of its 2004 expenditure for education and health, notably scheduling an increase in the state's own resources devoted to the sectors. The PRSP establishes a base of indicators that makes it possible to follow economic and social progress in Senegal, particularly the realisation of the Millennium Development Goals. The Senegalese household survey (Esam-2) – which provided the initial values (2001 or 2002) for the majority of indicators – should assist in monitoring economic and social development.

The PRSP's starting point is that Senegal's health indicators are in line with the country's level of economic development. However, geographic distribution of access to care is uneven, while some indicators – such as vaccination coverage – have deteriorated since the 1990s. The adoption of the PRSP marks the launch of a new health strategy focusing on: *i)* improving access to services to reduce infant and maternal mortality and malnutrition, as well as the frequency and severity of contagious diseases; *ii)* increasing the human and material resources in isolated regions; *iii)* strengthening the administration and management at all levels of care; and *iv)* increasing the beneficiaries' contribution to care financing while preserving access for the poorest. Since the beginning of this decade, there has been a turnaround in certain indicators. The vaccination figures for 2001 and 2002 are promising: vaccination coverage for DTC3 (diptheria, tetanus and whooping cough) increased from 44.7 per cent of the population to 59.9 per cent, while that of yellow fever went from 32.9 to 53.1 per cent.

Education is the second strategic axis of the PRSP. The allocation of resources is marked by the predominance of tertiary education to the detriment of primary education. It also underlines regional inequalities in primary schooling funding. According to the poverty monitoring unit (*Cellule de suivi du programme de lutte contre la pauvreté*, CSPLP) of the Finance Ministry, primary school enrolment rates reached 85.1 per cent in 2003, while the percentage of school-age children in full-time primary education was 75.8 per cent. The goals for 2005 are to increase these to 90 and 80 per cent, respectively. The CSPLP is focusing on reducing inequalities in terms of access to primary education: enrolment of girls increased from 80 per cent that of boys' in 2000 to 88 per cent in 2003. Some regional differences are also being reduced: regions such as Ziguinchor and Kolda that are traditionally poorer, reported over 100 per cent registration in the first year of primary school. In wealthier regions, enrolment is largely below the national average (such as Diourbel, where enrolment is 43.5 per cent, or in Kaolack, where it is 69.1 per cent).

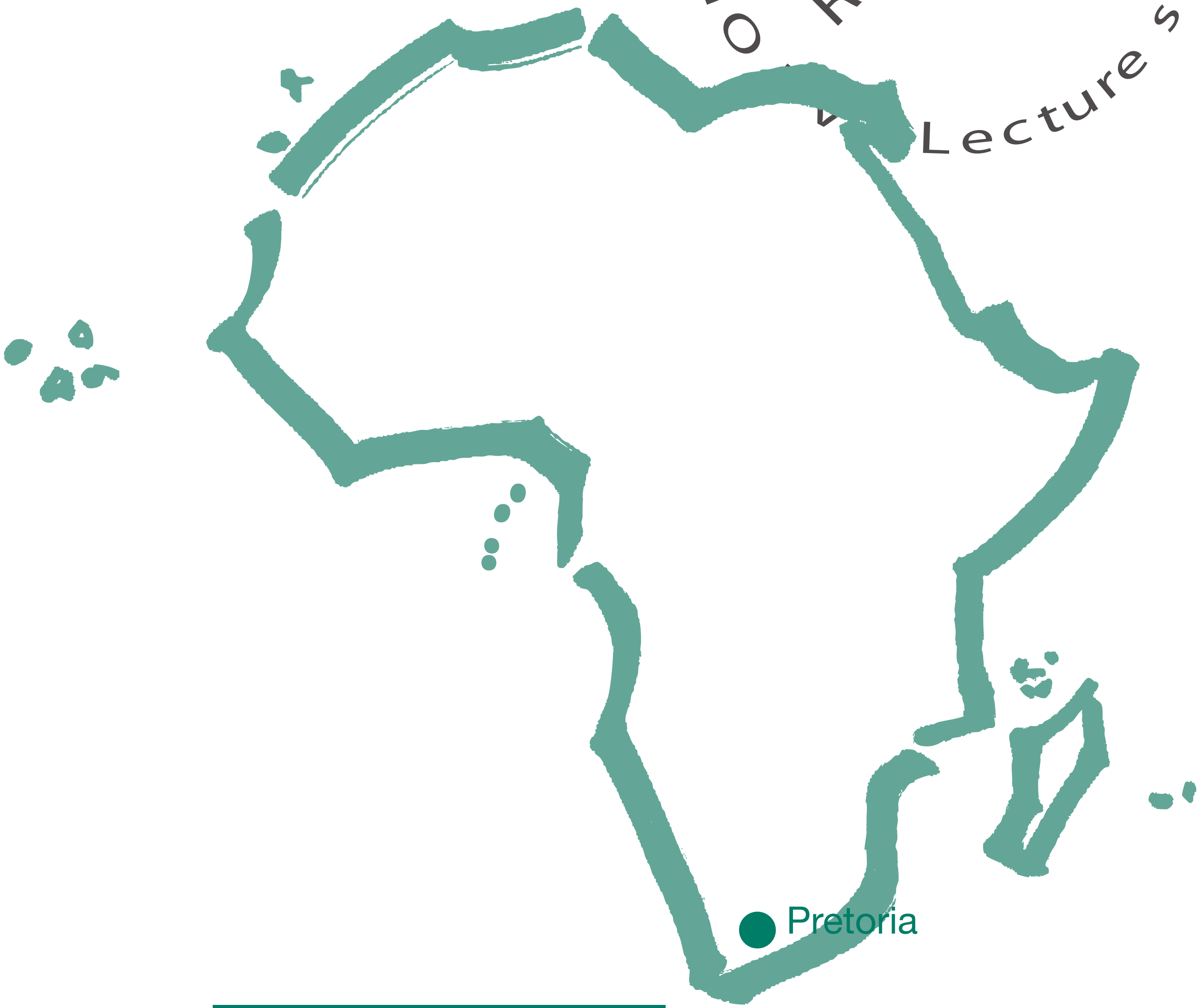
Adult literacy has increased, according to the CSPLP, from 39.1 per cent in 2001 to 40.2 per cent in 2003. This rate of progress, however, will probably not be sufficient to reach the goal of 45 per cent literacy in 2005. Also, it conceals great differences between male and female literacy. In fact, male literacy fell between 2001 and 2003, from 51.5 to 49.9 per cent, while female literacy increased slightly, from 28.9 to 30.8 per cent.

The process of collecting and analysing the demographic and socioeconomic data of the Esam-2 survey made it possible to measure the incidence of poverty in 2001/02 (48.5 per cent) and its geographic distribution (particularly high in rural areas and lower in Dakar and around Louga, for example). The poverty line is based on a minimum consumption of 2 400 kilocalories a day: a basket of 26 goods most consumed by households was defined and a monetary poverty line was fixed. The *Direction de la prévision et de la statistique* (DPS) in the Finance Ministry holds that economic growth between 2001 and 2003 should reduce the incidence of poverty in 2003 to 47.5 per cent.

In 2002, the DPS carried out a survey on the labour market in Dakar. This revealed that 51.1 per cent of the population over the age of ten was involved in the labour market (62.1 per cent for men and 41.1 per cent for women). In the strict sense of the word, unemployment was estimated at 11.7 per cent of the active population (9.9 per cent for men and 14.1 per cent for women). However, the problem remains one of underemployment rather than unemployment. If the number of those working less than the official working hours and those working for less than the minimum wage is added to the number of unemployed, underemployment is nearly 72.5 per cent of the active population in Dakar.

The average salary is 58 200 CFA francs, or around 110 dollars, though this varies markedly according to sector. Of the employed, 7.5 per cent work in the public or parapublic sector, where positions are more stable (average length of service is over 14 years) and better paid (149 700 CFA francs per month [283 dollars] in the administration and 134 700 CFA francs [254 dollars] in public companies). The proportion of workers in the formal private sector is 16.1 per cent, with average length of employment at 8.6 years and monthly salary averaging 113 100 CFA francs (214 dollars). The informal sector accounts for 76.4 per cent of workers, and the average salary is 39 000 CFA francs (74 dollars) per month, below the minimum wage. Workers in the informal sector also work longer (47 hours per week) than those in other sectors and have no social security benefits.

South Africa



key figures

• Land area, thousands of km²	1 221
• Population, thousands (2004)	45 214
• GDP per capita, $ (2003)	3 674
• Life expectancy (2000-2005)	47.7
• Illiteracy rate (2004)	13.3

NOTWITHSTANDING APARTHEID'S LEGACIES of inequality and poverty, the South African government's fiscal and monetary policies have been remarkably restrained. With low inflation, little indebtedness and a strong currency, the country is now in a favourable position to move more aggressively towards tackling its profound social ills, most crucially the pervasive unemployment. The government is increasing social spending and public works programmes while continuing to foster investment in physical and human capital. Weaknesses in government capacity, lack of skills and the AIDS pandemic remain major obstacles to accelerating economic growth to levels sufficient to absorb unemployment.

The South African economy appears to have adjusted to the strong rand. After slowing down to 2.8 per cent in 2003, owing to the adverse impact of the rand appreciation on exports, growth picked up again in 2004, at 3.8 per cent, spurred by buoyant domestic demand and a low interest rate environment, coupled with robust consumer and business confidence. Strong domestic demand and a favourable external environment are expected to bring growth to an average of 4 per cent over the next two years.

Despite a positive outlook, both investment and output growth are still below the levels necessary to reduce unemployment – which stood at 28 per cent in 2004 – and to achieve more equitable income distribution. Moreover, the country is faced with major social challenges, including a poverty level exceeding 50 per cent, a high prevalence of HIV/AIDS infection (20 per cent of the adult population), and an exodus of skills from an already inefficient health and education sector.

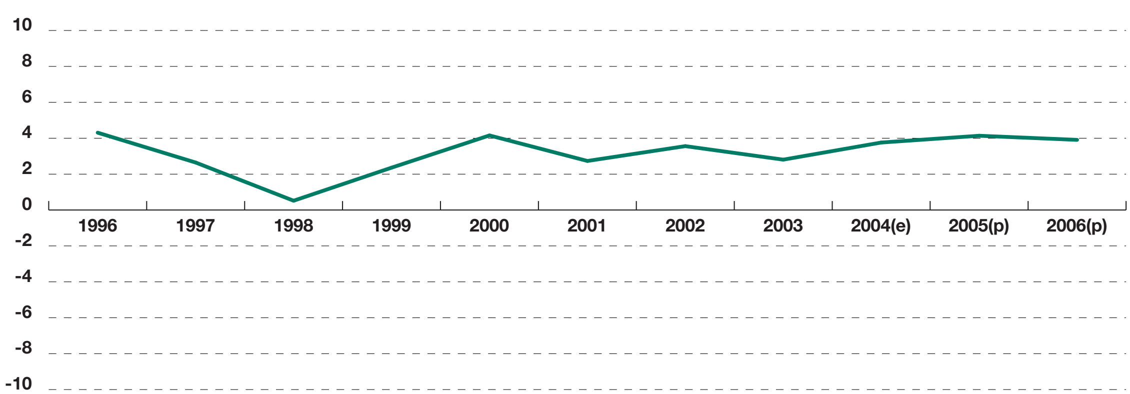
A successful macroeconomic stabilisation policy has provided room for more ambitious fiscal expansion.

Reducing poverty has moved to the top of the policy agenda. The 2004-2007 Medium Term Expenditure Framework has allocated increasing expenditures on infrastructure, public works programmes and income support schemes. This ambitious expenditure plan is confronted, however, with weak local government capacity and inadequate monitoring of budget execution, as highlighted by the 2004/05 overruns in social grants, mainly due to administrative failures.

Securing a two-thirds majority in the 2004 local elections, ANC consolidated its control over all the nine provinces. The dominant position of the ANC reflects the lack of a strong parliamentary opposition which was further reduced during 2004.

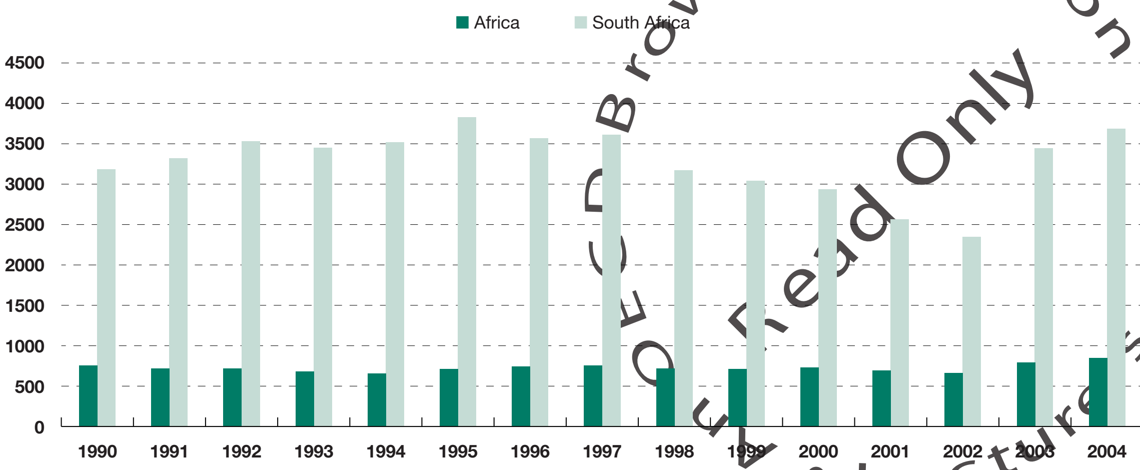
Recent Economic Developments

Figure 1 - **Real GDP Growth**



Source: South African Reserve Bank data; estimates (e) and projections (p) based on authors' calculations.

Figure 2 - **GDP Per Capita in South Africa and in Africa** (current $)



Source: IMF.

A highly competitive exchange rate boosted growth performance to 3.6 per cent in 2002. However, the strong appreciation of the rand experienced since the end of 2002 coupled with a sharp decline in agricultural production contributed to a slowdown to 2.8 per cent in 2003. The adverse impact on domestic exports was mitigated by a resilient retail sector.

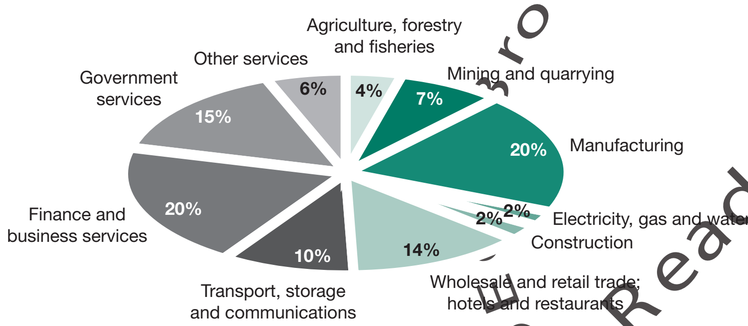
Growth regained momentum in 2004. The services sector continued to remain the main source of growth, especially transport and communication, while manufacturing and mining started to adjust to a more stable exchange rate.

Agriculture's share of total output is only about 4 per cent but it provides 10 per cent of the country's jobs. Agricultural production is extremely volatile, fluctuating with market prices and weather conditions. After a 5.9 per cent contraction in 2003 owing to poor weather conditions, agricultural output picked up in the second quarter of 2004, at an estimated pace of 7.4 per cent. Improved volume in the horticultural sector and animal products were the main contributors, while field crop production slowed in the face of declining prices. In the 2004/05 budget, the government set aside R1 billion ($168 million) to re-establish an Agricultural Credit Scheme, focused on the needs of new farmers and small-scale producers. The scheme aims at providing grants and loans for land acquisition and expansion as well as capacity building of small farmers.

As a result of the stronger rand, South Africa failed to gain much from the global commodities boom in 2003. Despite real growth in output and higher dollar prices, the strong appreciation of the rand translated into reduced rand revenues. The mining sector started to recover in 2004, growing by 4.1 per cent during the first nine months, as buoyant commodity prices partially offset the strength of the rand. The continued slow decline in gold production was balanced by robust growth in platinum, coal and diamond output. In particular, platinum output volume increased by 14.9 per cent in 2004, driven by automotive industry demand for use in catalytic converters. However, the development of the mining sector is constrained by inefficient infrastructure and by increasing operating costs (water prices and rail charges increased by 18 per cent and 16.5 per cent respectively in 2004, after increases of 8.5 per cent and 35 per cent respectively in 2003). Industry and government representatives are investigating ways of encouraging greater flexibility and lowering input costs.

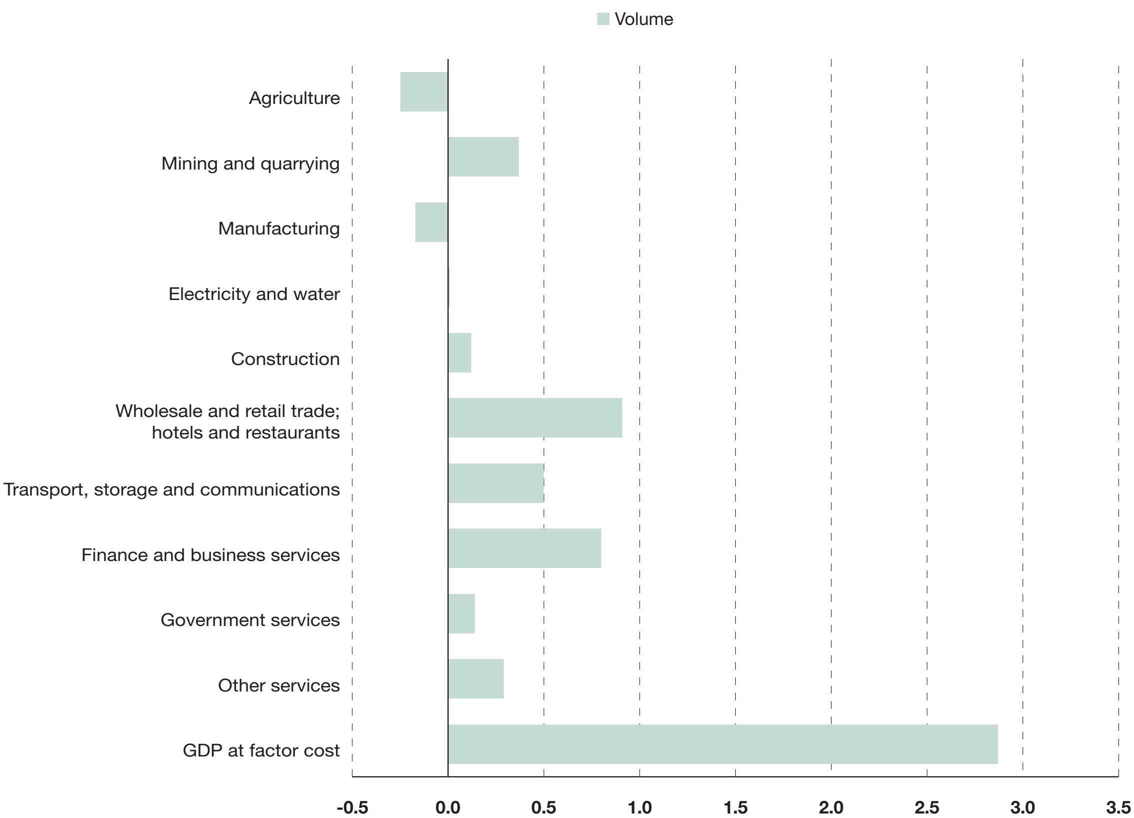
The pending Mineral and Petroleum Royalty Bill will further raise the industry's costs by R5 billion ($843 million), as it effectively raises taxes by 2-8 per cent of revenues on various minerals. Mining companies

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on South African Reserve Bank data.

Figure 4 **- Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on South African Reserve Bank data.

strongly oppose the proposed bill, arguing that royalties should be charged on profits rather than turnover.

Over the past two years, some progress has been achieved in promoting black economic participation in the mining sector, in line with the sector's empowerment charter, which calls for 15 per cent black ownership of mining companies' local assets within five years, increasing to 26 per cent in ten years. In 2004, a number of important mining empowerment deals were finalised, including the sale of 15 per cent of Gold Fields' South African gold sector to Mvelaphanda Resources, and the creation of Incwala platinum company, with 52.8 per cent of black shareholding. In addition, in compliance with the Mineral and Petroleum Resources Act approved in May 2004, progress has also been made in terms of employment equity, procurement from historically disadvantaged companies, and development of skills.

While the manufacturing sector strongly benefited from the depreciation of the rand in 2001 and 2002, the rebound of the currency constrained both export-oriented industries and the import-competing sector in 2003. The global economic slowdown also contributed to the poor performance of the manufacturing sector. The sector partly recovered in 2004, expanding by 2 per cent during the first nine months of the year, helped by the strength of domestic demand and export demand from Asia. Investment in manufacturing has increased despite subdued prices of manufactured products. The automotive industry was the best performing sub sector. According to the National Association of Automobile Manufacturers of South Africa, total domestic vehicles sales increased by 18.7 per cent in 2004, benefiting from the launch of the Toyota's exports to Europe and the commencement of Ford's export regime. These positive developments are mainly attributed to the Motor Industry Development Programme (MIDP) introduced in 1995, granting duty rebates on the components of exported vehicles. Vehicle producers can also obtain import duty credits through capital investment geared to export production. The programme has been extended until 2012.

The construction sector continued to grow at a rapid pace of 6.1 per cent in the first nine months of 2004. The expansion is due to the boom in construction of new residential buildings and shopping centres, supported by rising disposable incomes and growing consumer confidence. Favourable tax allowances for inner city property development and greater investment in township renewal are expected to support this sector further. Additional impetus in the medium term will come from planned investment in infrastructure by government and public corporations, including the extensions to the Johannesburg and Cape Town Airports and harbours of Durban and Richard bay. Moreover, South Africa's successful bid to host the 2010 World Cup will certainly provide a further important boost to the sector.

Over the same period, the service sector, which has been the backbone of growth in South Africa in recent years, also continued to perform well. Transport, storage and communications grew by an estimated 5.5 per cent. Growth was spurred by continued expansion in the telecommunications industry, notably with the introduction of a third cellular telephone operator – Cell C – in 2001. After some delay, the government is now in the process of negotiating with investors for a second fixed-line operator and is committed to ensuring effective competition by allowing mobile operators open and non-discriminatory access to all fixed-line networks. Strong demand for residential property resulted in increased activities in expansion of real estate and business services of 3.6 per cent in 2004.

Sustained by real wage increases and a reduction in income taxes, private consumption remained buoyant in 2004. Spurred by lower interest rates and the falling

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**17.2**	**15.3**	**16.1**	**16.8**	**17.1**	**18.8**	**20.4**
Public	4.5	4.0	4.1	4.7	5.2	6.1	6.8
Private	12.7	11.3	12.0	12.1	11.9	12.7	13.6
Consumption	**81.3**	**81.0**	**80.2**	**81.6**	**80.6**	**79.1**	**77.5**
Public	19.1	18.3	18.3	18.9	19.1	19.0	18.8
Private	62.2	62.7	62.0	62.6	61.5	60.1	58.7
External sector	**1.5**	**3.7**	**3.6**	**1.6**	**2.3**	**2.1**	**2.1**
Exports	24.7	29.8	32.5	27.2	25.7	26.5	26.9
Imports	-23.2	-26.1	-28.9	-25.5	-23.3	-24.5	-24.8

Source: South African Reserve Bank data; estimates (e) and projections (p) based on authors' calculations.

prices of imports owing to appreciation of the rand, household debt increased and real outlays on durable and semi-durable goods rose by 5 per cent in 2004. Real government consumption also increased over the same period, in line with the moderately expansionary stance of the 2004/05 budget.

Although still low when compared to other emerging economies, investment growth accelerated in 2004. Private sector capital formation has been spurred by several factors: low costs of imported capital goods, reduced borrowing costs, rising commodity prices, and control of inflation. Investment by public corporations, mainly in the form of purchase of new aircraft for the South African Airways fleet, contributed to the increase in investment.

Expansion in investment is expected to continue over the medium term as the government envisages investment in new electricity supply capacity, several major water schemes, and road and rail network rehabilitation. Major investment is also expected ahead of the 2010 soccer World Cup that will be financed through public-private partnership. According to the November 2004 Medium Term Expenditure Framework, the government foresees an increase in the overall investment-to-GDP ratio from the current 16 per cent to 25 per cent in 2014.

Relatively favourable global economic conditions accompanied by buoyant commodity prices suggest a gradual recovery of export performance. On the other hand, rising imports will accompany the acceleration in spending on capital goods.

Macroeconomic Policies

Fiscal and Monetary Policy

Since the start of the democratisation process, South Africa's macroeconomic policy has been aimed at enhancing the government's credibility by demonstrating to the international community its commitment to macroeconomic stability. Over the past ten years, South Africa has made significant progress in stabilising macroeconomic fundamentals. Public finances have been consolidated significantly, inflation has been brought under control, real interest rates have dropped and the external position has improved.

However, enormous social needs remain unmet and a large segment of the population is excluded from the formal economy and has limited access to services. The gravest problem continues to be the high unemployment rate, officially about 28 per cent in 2004, but as much as 40 per cent if disguised unemployment is included.

Since 2001, South African fiscal policy has edged away from fiscal austerity towards stimulus. However, despite growing emphasis on reducing poverty and increasing social spending, the fiscal stance has remained conservative. Deficit ratios in the past three fiscal years have been below target, reflecting shortfalls in social spending and the limited absorptive capacity of the provinces and local governments, to which about 60 per cent of expenditure is channelled.

In order to address pressing social challenges and improve the poverty impact of spending, the Medium Term Expenditures Framework (MTEF) for the period 2004/05 to 2006/07 proposes a more ambitious fiscal expansion. Increased emphasis has been placed on the role of the state in providing social services for the poor, increasing capital spending on economic infrastructure and social services, and providing tax incentives for investment. More specifically, the authorities are pursuing a two-pronged strategy focused in the short term on income support schemes and public works programmes, and in the long term on investment in social and transport infrastructure, and a more effective competition policy.

To this end, the 2004 budget targeted poverty reduction in the form of further extension of social grants for children in need, universal provision of antiretrovirals, labour-intensive public works programmes, and training for the unemployed. Additional outlays were allocated for the black economic empowerment programmes, land restitution, and the provision of free basic services to poor households.

In contrast with previous years, preliminary estimates of the 2004/05 budget suggest that, despite higher than expected business-tax receipts, overruns in social grants resulted in a deficit slightly higher than targeted at about 3.2 per cent of GDP.

Social grants were provided to close to 9 million people by the end of September 2004. This represents an increase of more than 2 million beneficiaries since April 2004. Disability grants for adults and children have been growing much faster than other grants. There are concerns that a significant part of this growth arises from fraud. The government opened an inquiry into the source of this unexpected increase, which might include the impact of HIV/AIDS, abuse, and unclear guidelines about how to treat conditions – especially chronic illness such as TB.

Concerns remain over the affordability and sustainability of these social services and income supports, as they could eventually crowd out development and education expenditure as well as threaten the hard-won fiscal stability.

The Medium Term Budget Policy Statement, presented in October 2004, proposes further increases in social spending as well as salary increases for teachers and police personnel. Investment in infrastructure – partly through public-private partnerships – is expected to reach 6 per cent of GDP, with the focus on improving railways, ports, electrification, schools and housing. These ambitious government plans are confronted however with weak local government capacity originating from an increasing shortage of skilled staff, as well as management deficiencies and inadequate systems for monitoring and evaluating performance.

On the revenue side, the government is proposing tax relief for investments from other countries within the Common Monetary Area (namely: Namibia, Swaziland and Lesotho), encouraging broad based employee equity participation and simplifying tax compliance for small enterprises.

Taking into account overruns in social grants programmes and the expected increase in capital expenditure, the overall budget deficits are expected to widen to 3.5 per cent of GDP in 2005/06 and to 3.7 per cent in 2006/07.

Over the past year, monetary policy has remained focused on containing the CPIX[1] inflation within the rolling monthly target range of 3-6 per cent. Since the peak of 11.3 per cent in November 2002, propelled by the lagged effect of the collapse of the rand in the latter part of 2001 and the poor performance of the agricultural sector, inflation decreased dramatically and has been within the target range since September 2003, averaging 4.3 per cent in 2004. The appreciation of the rand

Table 2 - **Public Finances**[a] (percentage of GDP)

	1996/97	2001/02	2002/03	2003/04	2004/05(e)	2005/06(p)	2006/07(p)
Total revenue and grants[b]	**22.5**	**24.6**	**24.8**	**24.3**	**24.8**	**24.4**	**24.1**
Tax revenue	21.9	24.2	24.4	23.8	24.2	23.9	23.6
Total expenditure and net lending[b]	**26.9**	**26.1**	**25.9**	**26.7**	**27.9**	**27.9**	**27.8**
Current expenditure	24.9	25.2	25.3	27.0	27.9	27.9	27.6
Excluding Interest	*19.8*	*20.5*	*21.1*	*23.2*	*24.2*	*24.3*	*24.1*
Wages and salaries	10.3	9.8	9.9	9.8	9.9	9.7	9.5
Interest	5.1	4.7	4.2	3.8	3.7	3.6	3.6
Capital expenditure	2.2	1.8	1.2	1.3	1.5	1.7	1.9
Primary balance	**0.7**	**3.2**	**3.0**	**1.4**	**0.6**	**0.1**	**0.0**
Overall balance	**-4.4**	**-1.5**	**-1.2**	**-2.4**	**-3.2**	**-3.5**	**-3.7**

a: Fiscal year begins 1 April.
b: Only major items are reported.
Source: South African National Treasury Statistics; estimates (e) and projections (p) based on authors' calculations.

1. The CPIX is defined as the consumer price index for metropolitan and other urban areas excluding the interest cost of mortgage bonds.

since end-2002, fiscal discipline, and slower rates of increase in food prices contributed to bringing inflation down. Despite high international oil prices and buoyant domestic demand in the course of 2004, there was little evidence of significant inflationary pressures as the negative impact of higher international oil prices was offset in part by the appreciation of the rand. A surge in petrol prices led inflation to reach 5 per cent in June, but it subsided to 4.2 per cent in July and 3.7 per cent in August and September.

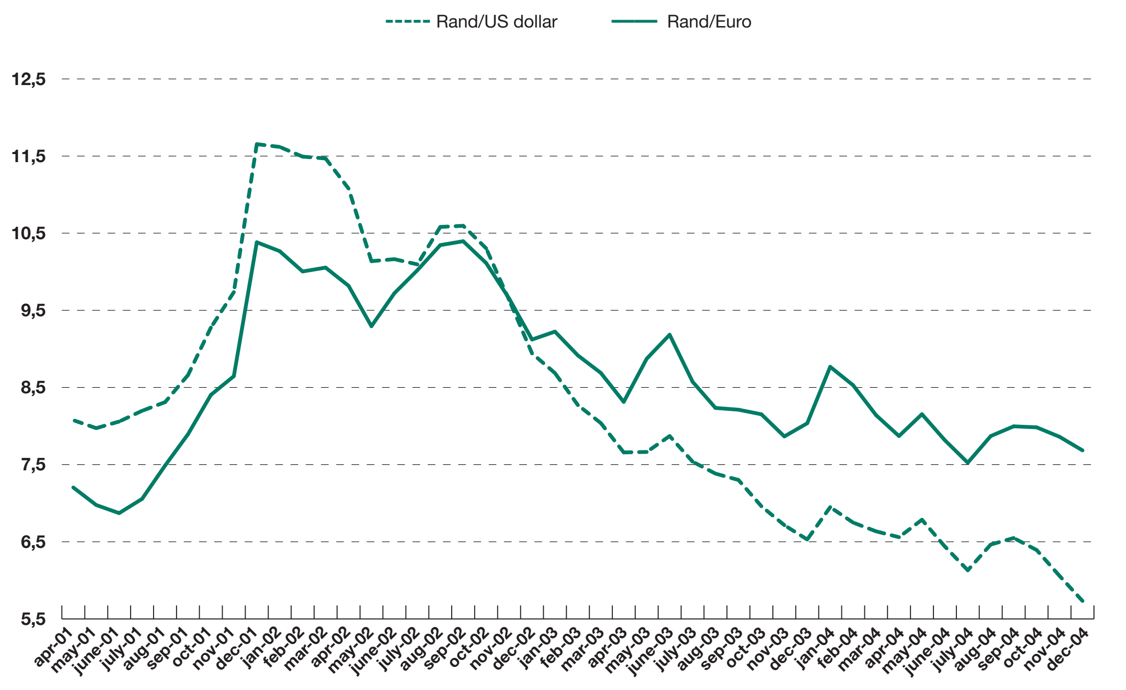
In turn, the favourable inflation outlook has allowed the Monetary Policy Committee to reduce the repo rate by as much as 600 basis points between June 2003 and August 2004.

Inflation is expected to remain in the range over the forecast period, at 5.7 and 5.1 per cent in 2005 and 2006, respectively. Though positive, the outlook for inflation still bears some risks, stemming from oil price developments and the continued rise in domestic expenditures.

After depreciating by 34 per cent between the end of 2000 and the end of 2001, the rand rebounded strongly against the dollar, appreciating by 24.2 per cent in 2002 and 16.2 per cent in 2003. The rand also appreciated against the euro, but to a lesser extent. In 2004, the exchange rate remained relatively steady after appreciating by 8.2 per cent in the first half of the year. Following an interest rate cut by the South African Reserve Bank (SARB) in August it slipped back to R6.50 per dollar. However, it stabilised quickly, and strengthened in the last quarter of 2004, ending the year at R5.7 per dollar.

The US dollar's weakness and high commodity prices have been fundamental drivers of rand behaviour. Other factors contributing to the recovery of the rand include a positive, albeit narrowing, interest rate differential with the rest of the world, and a continued positive market sentiment towards South Africa, in part as a result of a turnaround in the international reserve position of the SARB. Indeed, South Africa's reserve position has continued to improve significantly over the past months. Having stood at around $23

Figure 5 - **Rand Performance versus the US dollar and the Euro**



Source: South African Reserve Bank.

billion in 1998, the Net Open Forward Position (NOFP) was eliminated in May 2003 and the oversold book of the bank was closed out in February 2004. Since then, the Bank has continued to purchase foreign exchange with the objective of building up reserves in a prudent manner. At the end of September 2004, gross reserves amounted to \$12.4 billion.

If the removal of NOFP has contributed to reducing a source of vulnerability for the currency, the question of the durability of the rand's present strength remains open. Much of the strength of the rand might actually be driven largely by a surge in offshore transactions in rand derivatives (especially swaps), as reflected by the high level of unrecorded transactions in the financial account of the balance of payments.

External Position

After the failure of the international trade negotiations in Cancún in September 2003, where South Africa proved to be a vocal and effective participant, South Africa's focus moved in 2004 towards various bilateral trading arrangements.

A major development was the establishment of the Southern African Customs Union (SACU) Secretariat in Windhoek (Namibia) in July 2004. With the creation of a new more democratic institution and a new formula for the distribution of customs and excise duties, attention is turning to harmonization of trade and industrial policies. The new SACU Secretariat will enhance the participation of the smaller member countries.

The most advanced bilateral negotiations are between SACU and the USA, originally slated to start at the end of 2004. However, the date has been postponed to end-2005, on account of negotiations concerning the United States Africa Growth and Opportunity Act (AGOA) preferences. These preferences are especially generous to some BLNS (Botswana, Lesotho, Namibia, Swaziland) countries such as Lesotho, for which quotas and onerous rules of origin have been waved for textile inputs used in clothing destined for the US market. Some studies of the US-SA agreement, however, suggest that the United States will gain more in terms of market access than South Africa, given the much higher South African tariff levels.

South Africa is also considering a trade deal with China. South Africa exports almost \$1 billion of goods to China, mainly primary or lightly processed commodities, while it imports from China more than \$2 billion worth of higher value added and labour intensive goods in the clothing, glassware and electronics sectors. On the surface, it would therefore appear that South Africa will gain less than China from a bilateral FTA. However, South Africa could potentially sell a large number of manufactured goods to China, including chemicals, metal products and motor vehicles, that currently find their way to the rest of the world, in particular the EU. The competition from regional suppliers in the ASEAN countries may however be stiffer for South African exporters. Another promising avenue would be to encourage Chinese investment to South Africa, accompanied by Chinese entrepreneurship.

Despite its modest growth in the last five years, Europe remains South Africa's largest trading partner. In 2004, trade with Europe accounted for 35 per cent of total exports and 42 per cent of imports, while China accounted for 2.5 per cent of total exports. Trade with other African countries is still low but the recovery of the rand led to increased imports from the region. In June 2004, Africa accounted for 13 per cent of total South African exports and 4.5 per cent of imports. The bulk of exports to Africa goes to the SADC region and consists predominantly of manufactured goods, followed by agriculture and mining products.

After recording a surplus of 4.2 per cent of GDP in 2002, South Africa's trade balance narrowed to 2.2 per cent of GDP in 2003 as the skyrocketing rand seriously affected export earnings. Although in 2004 exports regained some lost ground, the trade balance has deteriorated considerably owing to a sharp rise in demand for imported goods.

In the first half of 2004, exports rose by 1.9 per cent, well behind import growth of 13.5 per cent. In rand terms, these numbers translate into a trade deficit of

Table 3 - Current Account (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	2.0	4.2	4.2	2.2	0.1	-0.1	0.0
Exports of goods (f.o.b.)	21.2	25.9	28.3	23.2	19.4	20.2	20.5
Imports of goods (f.o.b.)	-19.2	-21.7	-24.1	-21.0	-19.3	-20.3	-20.5
Services	-0.5	-0.5	-0.6	-0.6			
Factor income	-2.2	-3.2	-2.5	-2.0			
Current transfers	-0.5	-0.6	-0.5	-0.5			
Current account balance	**-1.2**	**-0.03**	**0.6**	**-0.9**			

Source: South African Reserve Bank data; estimates (e) and projections (p) based on authors' calculations.

R2.5 billion ($421 million), against a surplus of R14.5 billion ($2.4 billion) over the same period in 2003. Imports of capital goods, such as machinery, vehicles and transport equipment have dominated the surge, accounting for over three-quarters of total imports. Motor vehicles increased their share from 11 per cent to 14 per cent and fuels from 12 per cent to 15 per cent.

Within manufacturing, chemicals and metal products and machinery appear to have suffered marked declines in real exports during 2004. On the other hand, as noted earlier, thanks to increased platinum volumes and sustained commodity prices, basic metals and transport equipment recorded a moderate improvement compared to 2003, when the decline in rand prices neutralised the increase in volumes of gold and platinum. Agriculture, food and beverages, clothing and furniture also recorded increases in exports compared to a decline the year before.

Export growth is likely to pick up in 2005 and 2006, helped by anticipated depreciation of the rand against the euro, boosting manufacturing exports to the euro zone. Firmer commodity prices will contribute to higher gold and platinum exports. On the other hand, imports are also expected to continue to rise, mirroring the increasing trend of private and public investment.

While foreign direct investments in the country remain disappointing, South Africa is the main source of outward FDI in Africa ($500 million in 2003). In order to further support the global expansion and international competitiveness of Southern African companies, the 2004 budget abolished exchange control limits on new outward foreign direct investments by South African companies. Application to the South African Reserve Bank's Exchange Control Department will still be required in terms of existing foreign direct investment criteria, including demonstrated benefit to South Africa. In addition, South African corporations will be allowed to retain foreign dividends offshore.

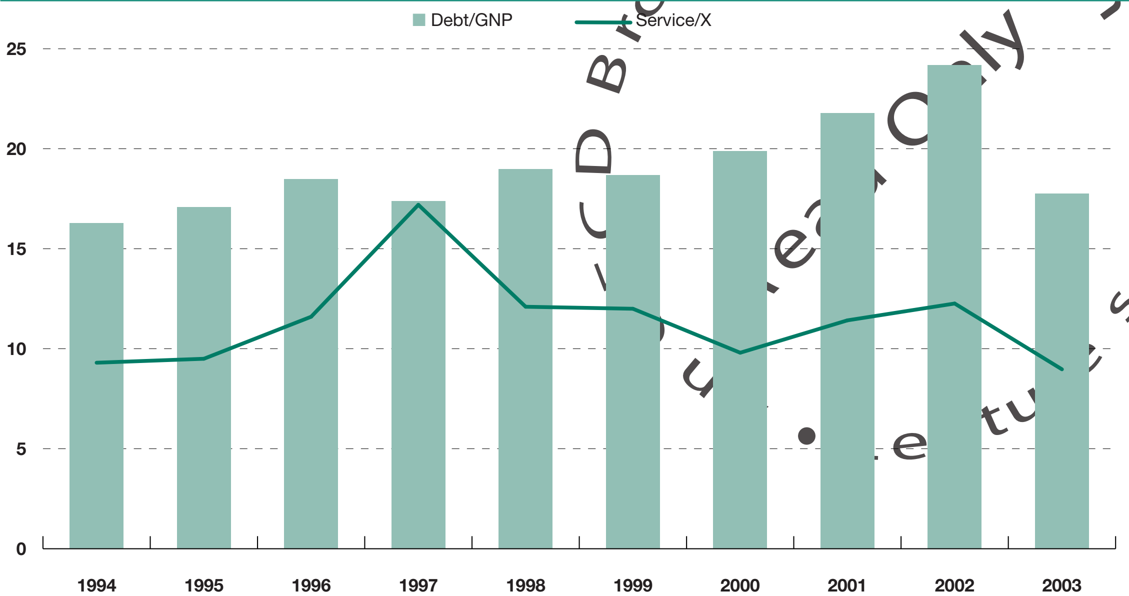
Major steps were also undertaken to promote foreign investment into South Africa and support the positioning of the country as a financial centre for Africa. The 2004 budget announced that foreign companies, governments and institutions may list on South Africa's bond and securities exchanges. The first foreign listing took place in November 2004 in the form of Aquarius Platinum, an Australian mining concern.

South Africa's foreign-currency denominated debt is around 10 per cent of GDP and it has been prudently managed by the authorities who intend to maintain it at this level in the future. In May 2004, South Africa issued an international bond of $1 billion that was heavily oversubscribed, highlighting the strong market confidence in the country's macroeconomic policies. In support of this positive sentiment, Moody's Investors Service upgraded South Africa's sovereign rating one notch to Baa1 in January 2005. In addition, Fitch has recently changed South Africa's sovereign rating outlook from stable to positive. South Africa has no programme with the IMF and has eschewed borrowing from the World Bank.

Structural Issues

In September 2004, the authorities undertook a review of the reform strategy for the major public

Figure 6 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

enterprises, aiming at accelerating efforts to improve management, accountability and efficiency of service provision. One of the pillars of the restructuring programme is also to foster black economic empowerment (BEE) through the sale of discounted shares and preferential procurement. The restructuring programme comprises various sectors, including defence, energy, telecommunications, forestry and transport. The intention is to promote greater investment by the public companies, attracting strategic equity partners or concessionaires.

To this end, the Department of Public Enterprises designed a R165 billion ($27.8 billion) five-year programme for expanding the power and transport systems. Over the medium term, the South African public enterprise for transport, Transnet, expects to expand the port, freight rolling stock, rail and pipeline infrastructure. Investment in the country's monopoly electricity provider, Eskom, includes major development of power generation, transmission and distribution.

The private sector laments the absence of government contributions in the R165 billion initial round of investment in electricity generation and transport capacity. Investors claim that initial public offering or sales of some of Transnet subsidiaries will require balance sheet restructuring that will not be possible to achieve without a new injection of funds.

The financial situation of Spoornet, the largest division of Transnet, responsible for rail freight and long-distance passenger services, is particularly weak and its restructuring will pose major challenges. The railways are estimated to have a 75 per cent deficit in capital spending (i.e. they are only investing 25 per cent of the capital required to maintain the existing fixed capital) with important negative implications for exports. The deterioration of the railway network's operating efficiency has indeed hampered South Africa's bulk commodity exporters' response to booming global demand, in particular from China.

The poor service of Spoornet also affects the South African Ports. Although the ports are highly profitable, the profits are used to compensate for losses in rail services, resulting in extensive inter-modal cross-subsidisation. Thus, port charges are higher than they need to be or investment expenditure is lower than it could be. The indirect impact of this policy choice is a tax on trade, reducing international competitiveness of South Africa's industries. This adds up to a general congestion of the ports, resulting in port delays and extra costs for exporters. Overall, the restructuring of Transnet will require a strong effort to reduce its operating costs, close loss-making lines, and deliver effective and competitive services. One option to attract private interest would be to sever the links between the infrastructure (ports) and monopoly service provider (rail and ports) controlled by Transnet. The existence of the cross-subsidisation mechanism poses, however, major challenges to this opportunity.

In the electricity sector, although Eskom's performance appears highly efficient when judged by African standards, a series of problems require attention. Chief among these is the imminent exhaustion of current capacity and the necessity of investing in new power plants. A "managed liberalisation" plan proposed in 2001 called for 10 per cent of Eskom's existing generation capacity to be sold under the BEE programme, followed shortly thereafter by the sale of an additional 20 per cent to a strategic foreign partner. In the medium term, transmission (wires, system and market operations) would remain an Eskom subsidiary before becoming an independent state-owned company. On the distribution side, six regional electricity distributors owned jointly by Eskom and the municipalities would be established. This unbundling programme was scheduled to commence in 2003, but has been postponed until 2006.

In terms of the public sector restructuring agenda, the authorities have put a strong emphasis on the importance of involving the local private sector, and in particular black business. To this end, the 2004 Medium Term Budget policy statement stressed the importance of fostering small micro- and medium-enterprises (SMMEs) development, especially through regulatory reforms, micro-credit initiatives and business support channelled through multipurpose community centres.

According to the 2003 Department of Trade and Industry annual review of small business, the number of small businesses in South Africa ranges from between 1.8 and 2.5 million among which between 1.25 and 1.9 million are non-VAT-registered. More than three-quarters of small companies are involved in services which are less capital intensive than agriculture, manufacturing and construction. Black-controlled informal SMMEs tend to specialise in trade, while white formal ones are involved in financial and business services (engineering and IT). It is estimated that SMMEs account for three-quarters of employment in South Africa, of which micro enterprises account for about 40 per cent. SMMEs generate around 30 per cent of the country's GDP.

Although less unfavourable than in most African countries, the business climate in South Africa is hindered by lengthy administrative processes, inappropriate and underdeveloped financial instruments, and high levels of informality. According to the Regulatory Compound Cost Survey, smaller South African enterprises face regulatory costs as a ratio of sales 80 times higher than bigger enterprises.

In addition, business associations lament extensive state interference in the form of administered prices, labour-market regulations, and black economic empowerment requirements. Field interviews suggest, however, that many companies manage to circumvent the minimum wage rules, for instance. More than in the cumbersome regulation in itself, the major problem seems to lie in frequent changes in regulations.

The strong rand adds to the burden of small businesses, undermining their ability to export. Increased competition from Asia, which could worsen with the FTA with China, is also highly detrimental to SMMEs.

The commercial banks tend to restrict lending to large formal companies. SMMEs, which usually lack proper financial accounts and collateral, are in general unable to borrow from banks. Other financial instruments, such as factoring and leasing, are very little developed. Small businesses also cite a general lack of information about available financing facilities and substantial red tape in access to them, as well as physical distance from the support institutions. These constraints lead many SMMEs to seek financing through other channels.

Outside the formal banking sector, small scale and co-operative banking – via the so called Stokvels – is established in the black community and has taken on increasing importance. It is estimated that 60 per cent of Stokvel users already have bank accounts for various transactions but use stokvels for savings and loans. Most stokvels remain unregulated.

A three-pronged strategy seems to be pursued by the authorities to foster SMME development and their access to finance. On the one hand, the regulatory framework is being adapted to allow existing financial institutions to better serve the needs of the SMMEs. In addition, the development of SMMEs is encouraged through the development of franchising and subcontracting. Thirdly, in the framework of the Black Economic Empowerment initiative, specific charters are issued to assist small- and medium-sized black businesses.

In late 2004, as a part of the recently launched activities to support SMMEs development, the authorities started a review of the regulatory framework for SMMEs focusing on lifting of lending limitations of microfinance institutions, the development of second tier banks (mortgage banks) and third tier banks (co-operatives) better suited to the needs of SMMEs, and the launch of credit registers to disseminate information

Innovative Financial Solutions: Increasing Reputation, Franchising is a Successful Avenue for SMME Financing

Franchising developed in South Africa when the country was under embargo. Since its opening, the country has been spreading franchising technology to Southern and Eastern Africa, using its good knowledge of African markets and exporting South African brands. Franchised companies have a 90 per cent success rate. This reputation has allowed for greater access to finance. According to the Franchise Census 2004 conducted by ABSA, (a large bank group), the total number of outlets operated by franchised systems in South Africa is almost 23 000, mainly concentrated in retail and restaurants. The estimated annual turnover generated by the franchising system is 129 billion rand and its contribution to GDP was 6 per cent. The franchise sector employs a total of 232 500 staff, of whom 59 per cent are black employees.

Greenfield Venture Capital from Cape Town is currently launching a new fund that will provide equity capital and the intensive management support to franchising outlets. The fund would be subject to the following investment criteria: the business must have a trading history of at least one year, the investment range should be between R100 000 ($16 000) and R2 million ($337 000), the type of investment should consist of 25 per cent to 49 per cent equity. Since most of the franchise outlets do not by themselves generate the value creation that venture capital funds need to cover their cost of capital, Greenfield is asking the Western Cape government to support a pilot project in order to remunerate investors for their contribution to the transition of these enterprises to a formal and businesslike sector. This appears to be a promising new trend in the quest for SMME financing.

Business Partners (formerly the Small Business Development Corporation) support qualifying small business by providing investment of up to R.15 million ($2.5 million) using equity, shareholders' loan account, royalties and term loans. Applications for investment financing of below R250 000 ($42 150) are usually not considered; the average investment is between R500 000 ($84 300) and R.7 million ($1.2 million). Funding is granted based on the viability of the business, the expertise of the individuals involved in the structure and the financing requirements. Equity based investments account for 40 per cent of the total investment portfolio. Investments are spread over manufacturing, retailing, travel and tourism.

available on SMMEs and improve their creditworthiness. Moreover, the authorities created a unified development agency, through the merger of Ntsika, the non-financial business support institution, with the National Manufacturing Advisory Centre. Although welcoming these initiatives, the business community laments the lack of a comprehensive entrepreneurial strategy and is sceptical about the capacity of the newly established agency to assist small business.

As shown in the box on the previous page, franchising has proved to be a successful avenue for SMMEs' development and has facilitated access to finance through formal channels, by providing information, access to markets, and capabilities. In particular, programmes have been launched to assist franchising outlets through management support and access to equity capital.

The Black Economic Empowerment (BEE) Act's provisions to give preference to black-owned enterprises in procurement bids is another potential way of favouring access to finance, through increased reputation. Although subcontracting arrangements between large companies and BEE SMMEs have developed rapidly since the approval of the act, they remain restricted to some unskilled functions. South African corporations have largely limited outsourcing to cleaning, basic construction and security, while retaining core activities, such as engineering and maintenance, ultimately limiting those firms' growth and development.

A major breakthrough in the government's black economic empowerment strategy was the issuance of the financial sector charter in the last quarter of 2003. The charter provides a framework and scorecard against which financial services providers can measure their progress in empowering historically disadvantaged individuals and communities. It requires financial institutions to increase financial services to the unbanked, support agricultural development, finance for low income housing, and assist small- and medium-sized black business. The charter also mandates significant increases in black ownership and control, management and skills development over the next 10 years. Financial institutions are also expected to procure services from BEE-compliant and black-owned businesses, reaching two-thirds of all purchased services within a decade.

Although some of the objectives appear ambitious, it is not expected that the financial soundness of South Africa's banking system will be jeopardised. Overall, the country's banking indicators are healthy and the sector received a strong vote of confidence in October 2004, when Barclays confirmed its intention to acquire ABSA, the biggest retail bank.

The five local banks that dominate 87 per cent of the market are starting to comply with the charter's targets. In 2004, ABSA was the first bank in South Africa to announce a black empowerment deal. Moreover, the launch of low-cost bank accounts for low-income earners is an important step forward. The "Mzansi" account, initiated jointly by the five banks in October 2004, had already reached 300 000 customers at the end of the year.

Political and Social Context

The African National Congress (ANC) won a resounding 69 per cent majority in the general elections of April 2004, with President Thabo Mbeki retaining the presidency of the country. The ANC obtained its first two-third majority in parliament, and appointed all nine provincial premiers, after previously having governing majorities in only seven provinces.

The dominant position of the ANC reflects the lack of a strong parliamentary opposition, also highlighted by the disappearance of the Zulu-based InKatha Freedom Party from the new Cabinet. The fact that the ANC has such a broad constituency has made it difficult for opposition parties to establish an identity that is both credible and distinct from the ruling party, and some have been absorbed by the ANC. Observers interpret the ANC's increased supremacy as a further sign that the country is slowly becoming a one-party state. The ANC is faced with the difficult task of balancing the interests of the white and new black business community against the poor, in the context of a still fragile democracy and high levels of economic inequality.

While the ANC's prudent economic management over the past 10 years is widely recognised as a great achievement, much less progress has been achieved in reducing inequality and poverty. South Africa continues to face formidable challenges with unemployment at about 28 per cent, 20 per cent rates of HIV infection, and widening income inequality (the Gini coefficient is 0.59 per cent).

The persistent high unemployment rate is a huge challenge facing the government. Economic growth rates have so far been insufficient to absorb the growing pool of unemployed labour. Moreover, much of the unemployment is structural, reflecting the chronic skills imbalances inherited from the apartheid education system, as well as obstacles to labour market flexibility and high labour costs.

In his June 2004 State of the Nation speech, President Mbeki vowed to halve unemployment by 2014. He proposed a longer-term strategy based on investment and educational reform along with public works programmes to temporarily increase employment. Launched in May 2004, the Expanded Public Work Programme aims to create 1 million temporary jobs during the five-year term of the current government in a range of sectors including labour-intensive construction, and home- and community-based health care.

The acceleration of land redistribution represents another priority means to reduce poverty and promote rural employment. The willing buyer-seller land reform programme aims at transferring 30 per cent of white-owned farmland to black ownership by 2015. Although progress has recently been made in restoring land to owners dispossessed during apartheid, the pace of land redistribution is still disappointingly slow, owing to administrative constraints. To date, only 3 per cent has been restituted or redistributed and 80 per cent of commercial farmland is still owned by some 50 000 white producers.

By the end of 2003, an estimated 5.3 million South Africans were infected with HIV, the largest number of individuals living with the virus in a single country. Since the epidemic began, the government has been criticised for its failure to take effective action against AIDS. The lack of a comprehensive and co-ordinated response by the government and lack of co-operation between the government and NGOs have been exacerbated by President Mbeki's controversial stance. Despite a court ruling in July 2002 that requires the government to provide antiretrovirals for infected children, the government has been slow in meeting its obligations. Treatment and prevention measures have been primarily led by charity and international aid organisations, pressure groups and, increasingly, private-sector companies of which about 68 per cent currently have an internal HIV/AIDS strategy.

International and internal pressure, as well as the political imperative of the 2004 election compelled the government to act more decisively. In November 2003, the government approved a $1.7 billion Comprehensive National Plan on HIV and AIDS Care, Management and Treatment, which aims to provide access to antiretroviral treatment (ARVs) to more than 1.4 million South Africans by 2008. However, since the launch of the initiative, little progress has been made. In June 2004, only 20 000 people had access to ARV treatment out of 750 000 people in need. Access to ARVs has been very uneven across the country as provinces face different challenges, including insufficient human resources, lack of training of health care workers, lack of treatment literacy, delays in the procurement of the drugs, and the need for specialised equipment.

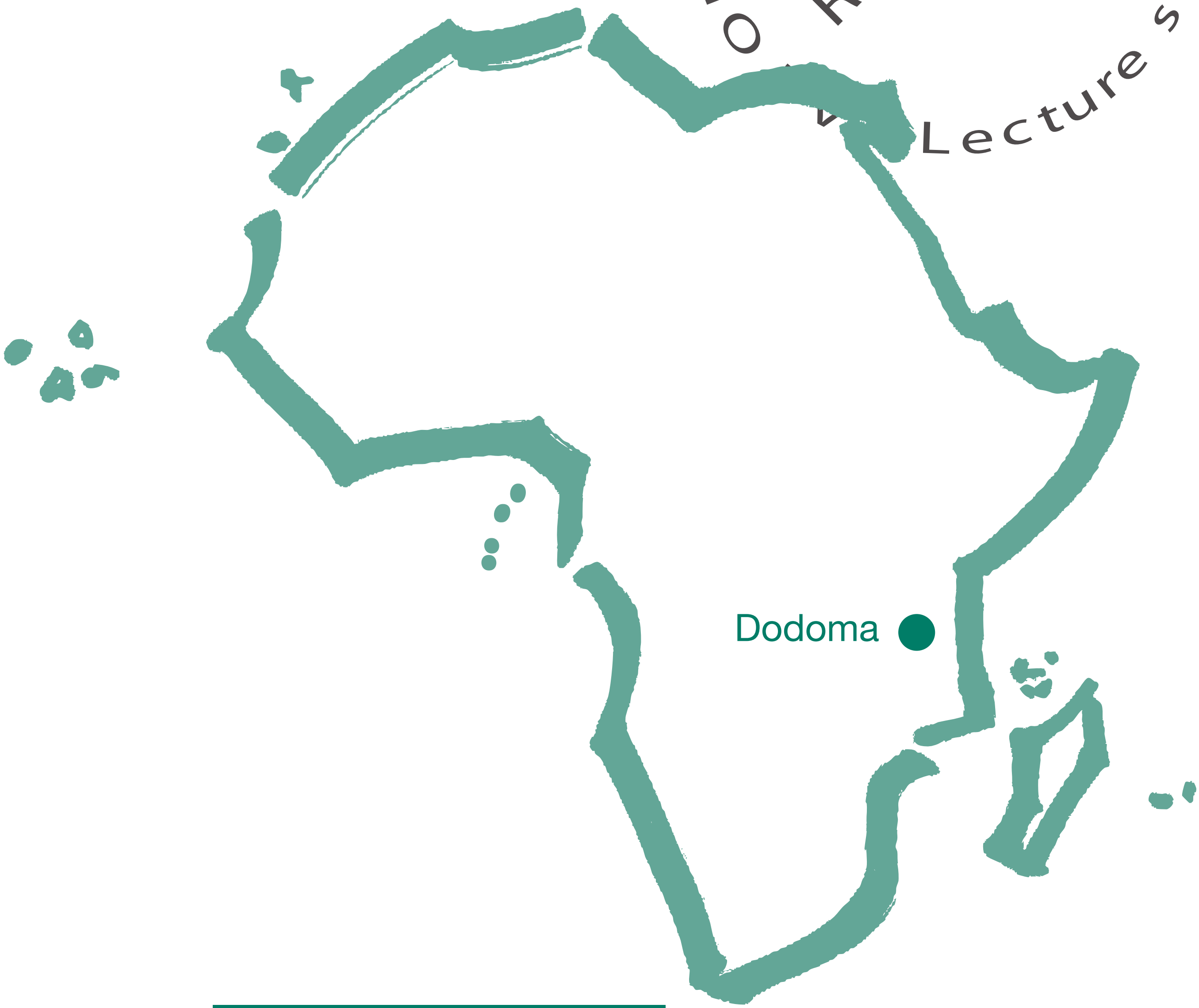
Further progress will depend on leadership at the provincial level. Questions remain about the extent of political commitment to the plan, given the reluctance in parts of the government to act on HIV/AIDS with appropriate urgency.

In the education sector, near-universal primary school enrolment has been achieved as suggested by the latest available education statistics. Gross primary school enrolment reached 105 per cent in 2002. Gross secondary school enrolment was 86 per cent in 2002, a 15 per cent increase from 1992. Classroom sizes fell from 43 in 1996 to 38 in 2001.

Despite these successes, the quality of education remains alarmingly low relative to the government's allocation to the sector (about 5.5 per cent of GDP per year from 2001 to 2004). This reflects the apartheid legacy of the very unequal access to learning resources in the country, as well as failure of some provinces to manage government's allocations properly. A major problem lies also in the teacher brain drain. A recent survey showed that a high number of South African teachers, including many of the best educated and trained leave the country after qualifying, attracted by higher foreign salaries. Up to 5 000 South Africans are teaching in London alone. This poses major challenges to the country's skill development.

The Growth and Development Summit which took place in June 2003 bringing together representatives from government, business, labour and local communities, was an important first step towards addressing the daunting skills problem. The agreements arising from this summit focused on promoting literacy, learnerships, strengthening the Sector Education and Training Authorities (SETAs) and broadening access to quality education and basic services. With funding from the SETAs and the National Skills fund, business and government have undertaken to draw up a register of least 72 000 unemployed learners by May 2004. However, despite the positive uptake, in the second half of the year, SETA underwent a profound funding crisis and failed to finance the promised skills development grants to its members. At the end of the year it declared a moratorium on new learnerships until at least July 2005.

Tanzania



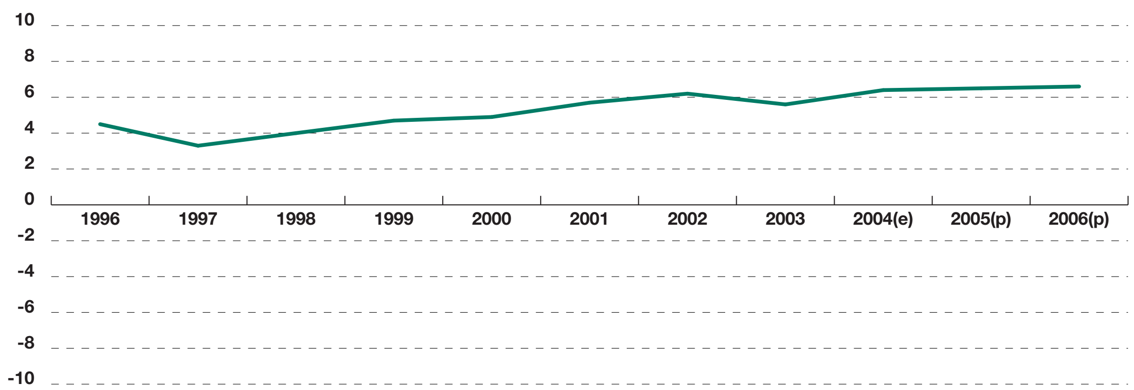
key figures

• Land area, thousands of km²	945
• Population, thousands (2004)	37 671
• GDP per capita, $ (2003)	278
• Life expectancy (2000-2005)	43.3
• Illiteracy rate (2004)	20.9

SINCE 1995, TANZANIA has successfully pursued economic reforms, resulting in accelerating economic growth and decelerating inflation. Strong growth and fiscal restraint in spite of a serious drought in 2003, demonstrates an impressive resilience. GDP growth has been 5.6 per cent in 2003 and is estimated at 6.4 per cent in 2004[1]. Yet, the share of manufacturing in GDP has only slightly increased from an average of 8.3 per cent during 1997-99 to an average of 8.4 per cent during 2001-03[2]. Growth in manufacturing is expected to take off soon due to various recent policy measures. Significant progress has been made in terms of increasing the share of exports in GDP which has increased from an average of 17.1 per cent during 1997-99 to 26.9 per cent during 2001-03. This progress in Tanzania's export growth along with reaching the Heavily Indebted Poor Country (HIPC) Initiative completion point in 2001 and an accelerated shift of donors from loans to grants, make Tanzania's external debt under current projections relatively sustainable. Yet, the current exploitation of natural resources, especially of gold, upon which most of Tanzania's export growth rests, will not be sustainable in the long term. As described in Tanzania's first Poverty Reduction Strategy Paper (PRSP), Tanzania has implemented an ambitious poverty reduction strategy during 2001-04, concentrating on primary education, roads, water and sanitation, the judiciary, health and agriculture. The PRSP has been updated via progress reports in August 2001, March 2003 and March 2004. In November 2004, the government of Tanzania (GoT) concluded its second PRSP, the *National Strategy for Growth and Reduction of Poverty (NSGRP)*. Tanzania's efforts have resulted in considerable progress in some social indicators, including increases in the net enrolment ratio for primary schooling (from 59 per cent in 2000 to 89 per cent in 2003), an increased ratio of the population with access to water (from 32 per cent in 1990 to 58.3 per cent in 2003), and a general decrease in poverty (measured in terms of consumption of basic goods and services). The country

Sustained strong economic performance and high levels of donor support offer the opportunity to break out of the poverty cycle.

Figure 1 - **Real GDP Growth**



Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

1. There are considerable differences in Tanzania between real GDP growth rates based on GDP at market prices and GDP at factor costs, with the latter lower than the former. For reasons of consistency with some other low-income countries as well as last year's AEO, real GDP growth rates are reported here based on GDP at factor costs.
2. Three-year averages are provided to minimise the impact of temporary fluctuations.

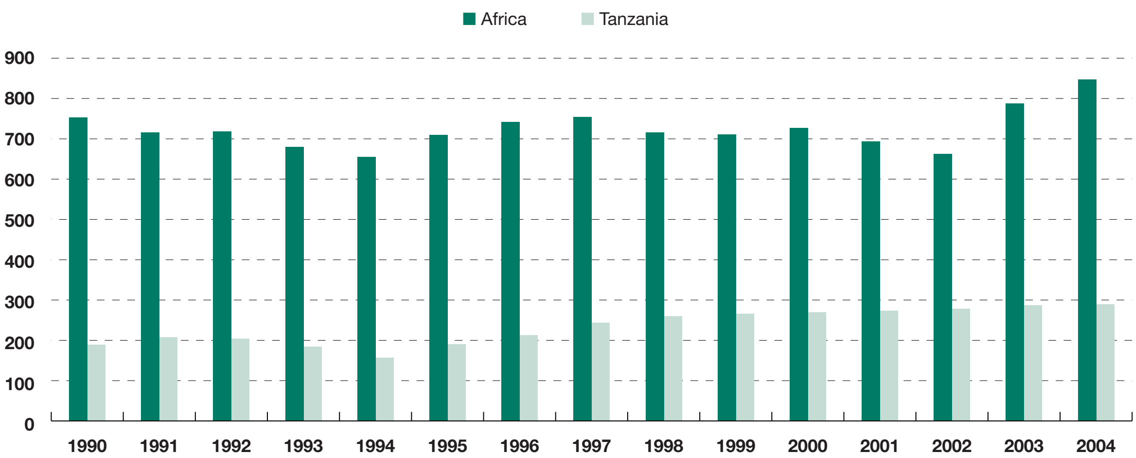
also enjoys political stability with elections set for 2005. Nonetheless, Tanzania remains one of the poorest countries of the world and is highly dependent on foreign aid. In addition to maintaining macroeconomic stability, sustainable growth and poverty reduction require further structural reforms, especially in areas such as agriculture, infrastructure and the legal system. Tanzania has been identified as a likely candidate for the Millennium Development Goal (MDG) fast-tracking which, if realized, would give Tanzania a considerable boost in terms of poverty reduction and growth[3].

Recent Economic Developments

Building on the macroeconomic stability achieved since the mid-1990s, the economy is enjoying growing resilience against adverse shocks. This became apparent in 2003, as the economy grew at 5.6 per cent in real terms despite a drought, following 6.2 per cent growth in 2002. Based on resurgent agricultural growth, real GDP growth in 2004 is projected to reach 6.4 per cent. Assuming that currently favourable developments in the manufacturing and mining sectors will continue, the authorities target an average real GDP growth rate of nearly 7 per cent over the medium term. Reflecting the unfavourable weather conditions in 2003, the share of agriculture fell slightly from 47.5 per cent in 2002 to 46.7 per cent in 2003, while strong growth in the industry sector has resulted in its increase from 22.1 per cent to 22.8 per cent of GDP. The share of the service sector decreased marginally from 35.1 per cent to 35 per cent of GDP[4] as industrial production grew stronger than the service sector.

Over the last few years, Tanzania has made progress in growing drought-resistant crops, of which a few are traditional crops in some areas. The drought resistant crops have maintained real agricultural growth at a respectable 4.1 per cent during the 2003 drought year. Yet, the effects of the drought would have been mitigated even further if distribution channels across regions within Tanzania, especially from surplus to deficit regions, were further developed. Given the lack of such channels and the preference to move some food crops across borders (aided by the Cross Border Trade Initiative), food security remains a critical issue in Tanzania. Furthermore, the agricultural sector remains constrained by weather conditions, the small size of farms, and inadequate use of technology. The GoT

Figure 2 - **GDP Per Capita in Tanzania and in Africa** (current $)

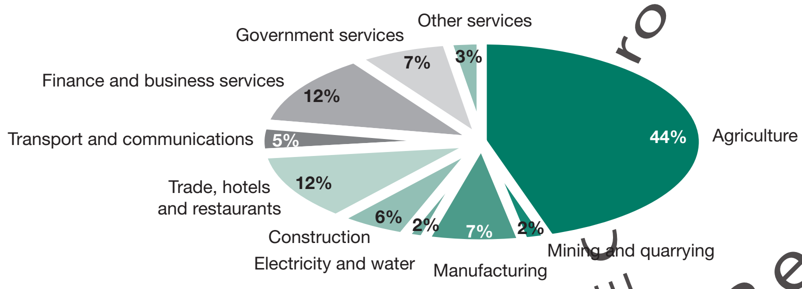


Source: IMF.

3. See the Millennium Project's Report to the UN Secretary-*General Investing in Development – A Practical Plan to Achieve the Millennium Development Goals*, January 2005.

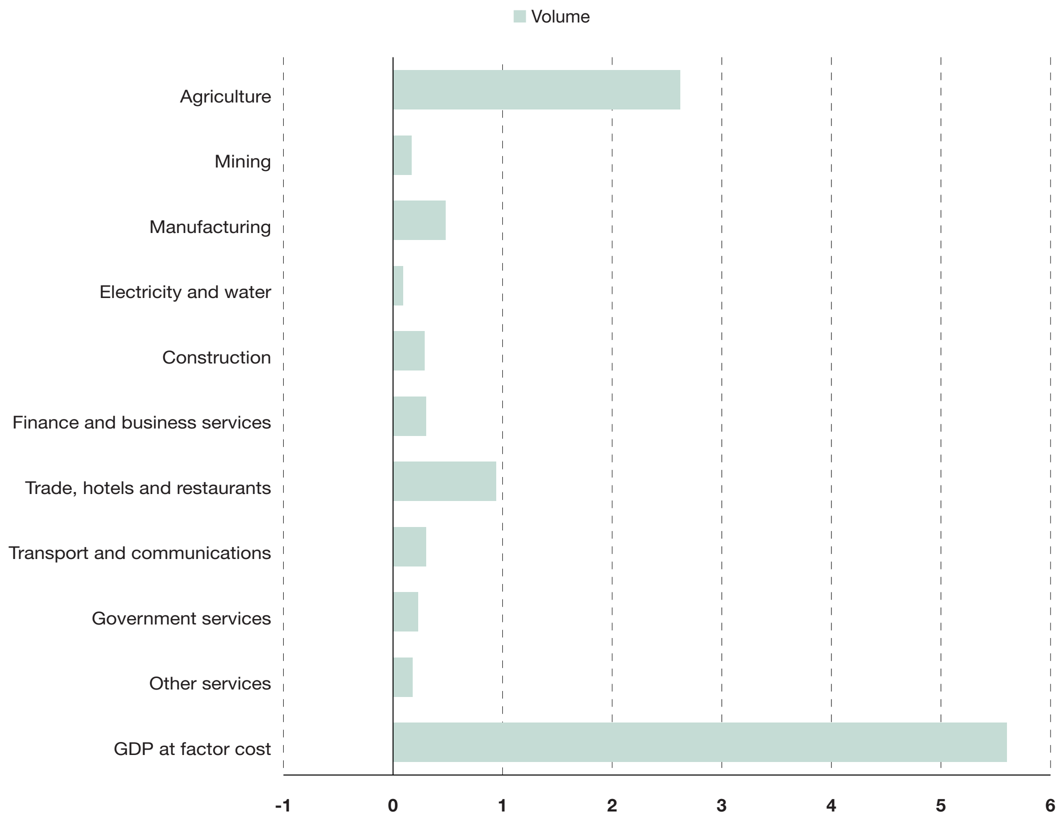
4. The shares of agriculture, industry and services add up to more than 100 per cent as imputed bank service charges, amounting to about -4.7 per cent of GDP in both years, are not allocated to the various sectors.

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

continues to support sustainable growth in the agricultural sector through efforts to attract large-scale investments, subsidies to the transportation of fertiliser in the main cereal producing regions, increased funding for agricultural research and extension services, and the strengthening and rationalisation of the export credit guarantee scheme.

The industrial sector's rapid growth is mainly due to strong performances in manufacturing, construction, and especially in mining and quarrying. For the fourth year running, mining and quarrying output grew more than 13 per cent in real terms, reaching a growth rate of 17 per cent in 2003. Real growth in construction had reached 12 per cent in both 2002 and 2003, while real growth in manufacturing was 8 per cent in 2002 and 8.6 per cent in 2003. Electricity and water are the weakest growing subsectors, yet have each grown at about 5 per cent in 2003. While industrial sector growth is unlikely to maintain these exceptional rates in the long run, preliminary estimates for 2004 indicate that the industrial sector boom is continuing, at least in the near term.

Within the service sector, the hotels and restaurants subsector continues to exhibit the fastest growth, notwithstanding a slight decline from 7 per cent in 2002 to 6.5 per cent in 2003. Transportation and communications growth fell to 5.1 per cent in 2003 from 6.4 per cent in the previous year, partly due to the rise in fuel prices and the slowdown in the agricultural sector. Public administration is the most stagnant sub-sector within the service sector, growing at 3.8 per cent during 2003 (the same as in 2002). Financial and other services continued to grow at around 5 per cent in real terms. Preliminary estimates for 2004 indicate healthy growth in the service sector, with the strongest growth in the transportation and communications subsectors.

The expenditure composition of GDP reveals an increase in the shares of both private and public consumption, and a decrease in the shares of investment

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**16.6**	**17.0**	**19.1**	**18.6**	**21.4**	**21.2**	**22.4**
Public	3.5	5.6	7.6	7.4	8.9	9.2	8.7
Private	13.2	11.4	11.6	11.2	12.4	12.0	13.7
Consumption	**95.4**	**91.2**	**87.1**	**90.3**	**89.2**	**91.1**	**90.1**
Public	11.6	6.2	6.3	6.5	7.1	7.8	7.5
Private	83.8	85.0	80.7	83.8	82.1	83.3	82.6
External sector	**-12.0**	**-8.2**	**-6.2**	**-9.0**	**-10.6**	**-12.3**	**-12.6**
Exports	19.9	15.5	16.1	17.8	17.9	18.1	17.6
Imports	-31.9	-23.7	-22.3	-26.7	-28.5	-30.4	-30.2

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

and domestic savings in 2003. The share of private consumption in GDP increased from 80.7 per cent in 2002 to 83.8 per cent in 2003 (partly due to changes in consumption patterns moving towards quality education and improved health services), while the share of public consumption in GDP increased from 6.3 per cent in 2002 to 6.5 per cent in 2003. While the shares of investment and savings in GDP decreased from 19.1 per cent and 12.9 per cent in 2002 to 18.6 per cent and 9.7 per cent in 2003 respectively, real investment grew, while savings fell even in nominal terms. In response to measures taken in fiscal year (FY) 2004/05 to boost savings and investment, preliminary results for 2004 indicate a recovery in savings and a significant increase in investment (see Table 1). As will be described in more detail below, the new measures include the creation of collective investment schemes, the establishment of a credit reference bureau, and improvements in the operations of credit guarantee schemes that aim at encouraging financial institutions to lend.

Macroeconomic Policies

Fiscal and Monetary Policy

Developments in fiscal policies have been satisfactory despite the drought, which necessitated the provision of additional financial resources to purchase and distribute food as well as to import oil to substitute for the loss in hydropower. Despite a limited increase in the overall fiscal deficit excluding grants from 7.8 per cent of GDP in

2002/03 to an estimated 9.6 per cent of GDP in 2003/04, and a further increase to a projected 12.5 per cent of GDP for 2004/05, longer-term projections show a decreasing deficit. The same applies to the overall fiscal deficit including grants which, under cautious assumptions about foreign aid, is expected to increase from 2.9 per cent of GDP in 2003/04 to 5.1 per cent of GDP in 2004/05. The widening deficit reflects increasing expenditures, especially for poverty reduction measures and the expenses related to the upcoming election, rather than falling revenues. The 2003/04 deficit is estimated to be smaller than previously projected, due to improved domestic revenue collection, frontloading of external budget support, and relative expenditure restraint. The GoT has ensured that expenditures on priority sectors for poverty reduction, namely health, education, water, roads, agriculture, judiciary and legal departments, are fully funded as planned, regardless of the extra expenditures on food and electricity associated with the drought.

Thanks to various reforms in tax administration and tax structure as well as higher petroleum taxes, the GoT exceeded its goal for domestic revenue collection in fiscal year 2003/04 by about 4 per cent, implying a 20 per cent increase in collections compared to the previous fiscal year. The tax reforms undertaken aimed at expanding the tax base, increasing accountability of tax collectors and tax payers, eliminating nuisance taxes, improving the business environment, and increasing the efficiency of the Tanzania Revenue Authority (TRA). Furthermore, a new Income Tax Act was passed by Parliament in April 2004, aiming at expanding the tax base and introducing a new culture of voluntary compliance in paying income taxes. Expenditure performance for fiscal year 2003/04 was broadly in line with budget estimates, reaching 97 per cent execution in recurrent expenditure excluding debt service, and 92 per cent of the budget for development expenditure. Full allocation for priority sectors was made at the beginning of each quarter and total actual expenditure was 98 per cent of estimates. Actual

Table 2 - **Public Finances**[a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants[b]	**14.6**	**15.7**	**16.2**	**18.3**	**19.7**	**20.4**	**20.9**
Tax revenue	11.3	10.7	10.6	11.0	11.8	11.9	12.0
Grants	1.4	3.7	4.4	6.2	6.8	7.4	7.8
Total expenditure and net lending[b]	**14.7**	**16.8**	**16.6**	**19.9**	**22.6**	**25.5**	**25.8**
Current expenditure	13.8	13.1	13.3	14.9	16.8	18.7	19.1
Excluding Interest	*10.4*	*11.4*	*11.9*	*13.9*	*15.7*	*17.4*	*17.9*
Wage and salaries	5.5	4.0	3.9	4.0	4.1	4.3	4.3
Interest	3.4	1.7	1.4	1.0	1.1	1.3	1.3
Capital expenditure	0.9	3.7	3.3	5.0	5.7	6.8	6.7
Primary balance	**3.2**	**0.6**	**1.0**	**-0.6**	**-1.8**	**-3.8**	**-3.6**
Overall balance	**-0.1**	**-1.1**	**-0.4**	**-1.6**	**-2.9**	**-5.1**	**-4.9**

a: Fiscal year begins 1 July.
b: Only major items are reported.
Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

expenditure in the category *Other Charges* registered a 94 per cent performance level.

During fiscal year 2004/05, the GoT plans to increase revenue from domestic sources to the equivalent of nearly 14 per cent of GDP, up 20 per cent from the government's revenue projections for 2003/04. The GoT's short- and medium-term fiscal policy objectives are to enhance domestic revenue, lower aid dependency, allocate higher expenditures for poverty reduction, and ensure that debt remains sustainable. Given that the planned expenditures will be about 26 per cent of GDP, the 2004/05 budget would have a financing gap of about 12 per cent of GDP which is expected to be covered largely by grant aid from bilateral donors and the European Union and by concessional loans and grants from multilateral institutions, specifically the

World Bank and the African Development Bank. A remaining financing gap of about 2 per cent of GDP is expected to be met by drawing down government reserves with the Bank of Tanzania (BoT) and through domestic sale of government securities.

Monetary policy has also shown remarkable progress, although the BoT remains confronted by the challenge of sterilising large inflows of foreign aid. Money supply was tightened, with its growth rate decelerating to 18.7 per cent at end-March 2004 from 22.7 per cent at end-June 2003. Credit to the private sector in domestic currency increased by 41.8 per cent between July 2003 and March 2004, fuelled in part by large corporations switching from borrowing abroad to borrowing domestically. The two major factors driving this switching were the need to avoid exchange rate risks and the lower borrowing costs stemming from increased competition among commercial banks. The interest rate spread between lending and deposit rates has declined from 13.1 percentage points in 2002, to 11.4 percentage points in 2003, and is estimated to have declined to about 10 percentage points in 2004.

The inflation rate increased slightly from 4 per cent in July 2003 to 4.6 per cent at end-March 2004. The increase in the inflation rate resulted from pressure on food prices following the drought and from the sharp increase in oil prices. Inflation is targeted at 4 per cent by end-June 2005 and is expected to stabilise at that level in the medium term. The government introduced a new and more appropriate weighting system for the consumer price index in September 2004 which will make inflation less sensitive to changes in food prices.

External Position

There has been a substantial increase in both imports and non-traditional exports. Imports have increased by 26.6 per cent in nominal terms in 2003, or in relative terms, from 15.5 per cent of GDP in 2002 to 18.8 per cent in 2003, largely due to sharp increases in imports of fuel and food. The increase in food imports was an obvious consequence of the drought. The sharp increase in fuel is also attributable to the drought as hydroelectricity was replaced by thermal power produced with petroleum. While there are some concerns about the impact of high oil prices on the balance of payments, the value and volume of petroleum imports are actually estimated to have fallen in 2004, due to resumption of hydroelectricity production as well as due to the introduction of natural gas as a substitute for petroleum[5].

Non-traditional exports increased by 16 per cent in 2003, mostly attributable to gold and manufactured products. Gold, though considered a non-traditional export, is now Tanzania's largest export. Traditional exports (coffee, cotton, tea, cashew nuts, cloves, sisal and tobacco) remained depressed despite some signs of recovery in the prices of coffee, cotton, tea and cashew nuts on the world market. Overall goods exports increased from 9.2 per cent of GDP in 2002 to 11 per cent of GDP in 2003. Receipts from tourism also rose during 2003. While the current account deficit increased slightly from 3.3 per cent of GDP in 2002 to 4.1 per cent of GDP in 2003, the increase in the capital account balance surpassed that of the current account balance, and for the first time since 2000, the balance of payments recorded a surplus of $243.9 million, equivalent to about 1 per cent of GDP. The Tanzanian Shilling remained relatively stable to the US dollar during 2004, though it first depreciated slightly during the first half and then appreciated slightly during the second half of 2004.

Taking into account the lower debt service payments due to debt relief, and an increase in official programme grants and loans, gross international reserves reached $1.97 billion in 2003, and continue to rise. As of end-March 2004, official foreign exchange reserves had

5. As of October 2004, the production of clean, reliable, efficient electricity generated from Tanzania's indigenous gas reserves extracted from SongoSongo Island in Kilwa (and transported through a 225 km long pipeline to the Ubungo Power Station) had reached 115 megawatts. Due to agreements finalised in November 2004, the total capacity of electricity generated from Tanzanian natural gas will increase to 180 megawatts by April 2005, which is enough to meet over one third of Tanzania's peak demand and the whole of Dar es Salaam's power requirements.

Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-6.9	-8.3	-6.2	-7.8	-9.2	-10.5	-10.5
Exports of goods (f.o.b.)	11.8	8.2	9.2	11.0	11.1	11.2	11.0
Imports of goods (f.o.b.)	-18.7	-16.5	-15.5	-18.8	-20.3	-21.8	-21.5
Services	-4.3	-0.1	-0.5	-0.9			
Factor income	-1.1	-0.9	-0.9	-0.5			
Current transfers	5.2	4.2	4.3	5.1			
Current account balance	**-7.1**	**-5.1**	**-3.3**	**-4.1**			

Source: IMF and domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

reached a comfortable level, equivalent to eight months of imports of goods and services. The GoT intends to draw down its reserves with the BoT and to borrow domestically by issuing short- and long-term securities to the amount of about $231 million. While it is expected that a small portion of these securities will be used to fund the export credit guarantee scheme, the majority is intended to settle maturing obligations. The GoT has continued to seek debt relief from the Paris Club and non-Paris Club creditors under the HIPC Initiative. Tanzania reached the enhanced completion point in November 2001. All Paris Club Creditors except Brazil offered Tanzania between 90-100 per cent debt relief on all bilateral debt. Steps have been taken to initiate and conclude negotiations with the Brazilian government. Within the group of non-Paris Club creditors, India has cancelled all intergovernmental loans, Bulgaria cancelled $15.1 million of bilateral debt, a preliminary agreement has been negotiated with Iran, and negotiations with the Abu Dhabi Fund are well underway. The GoT continues with its effort to negotiate debt relief with the remaining creditors at terms consistent with the enhanced HIPC framework. Negotiations with some non-Paris Club creditors and

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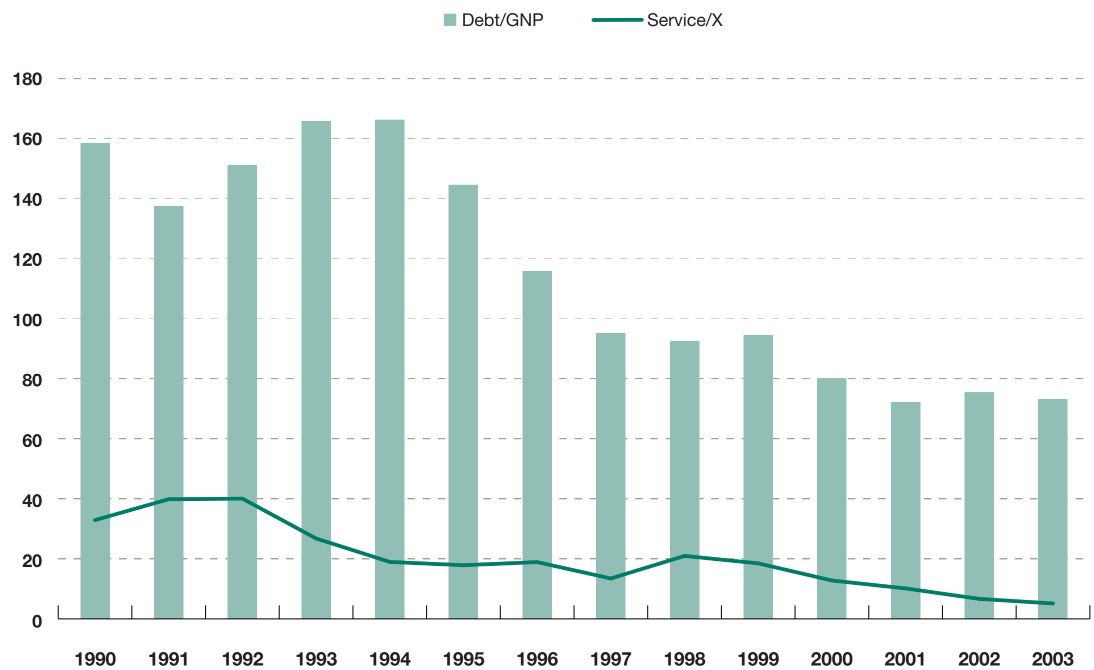
Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

most commercial creditors have been difficult and protracted, as these creditors seem unwilling to participate in the HIPC Initiative. Although the drought complicated Tanzania's macroeconomic situation, it is notable that neither external borrowing nor domestic financing exceeded their respective ceilings.

While the GoT intends to reduce its aid dependency, it also recognises that large amounts of foreign aid will still be needed over the foreseeable future in order to reach the MDGs. Based on Tanzania's satisfactory track record, its development partners are willing to provide their support increasingly through direct budget support as well as in the form of grants. Foreign assistance is co-ordinated through the Tanzania Assistance Strategy (TAS) that provides a framework to increase effectiveness of aid, through harmonisation and simplification of procedures to reduce transaction costs and bureaucracy. During 2003/04, donors including international financial institutions have contributed 45 per cent of the government budget, compared to 47 per cent during 2002/03. Based on agreements reached between the GoT and the development partners, Tanzania expects to receive grants and concessional loans equivalent to about 41 per cent of total expenditures during 2004/05 (of which about $510 million are for budget support and about $860 million are for development projects). While falling as a share of expenditures, this level of grants and loans represents an increase in nominal terms of close to $200 million (16 per cent) over fiscal year 2003/04. Given the open dialogue and consultative process as well as the successful past co-operation between the GoT and its development partners (including the achievements of the TAS and of Tanzania's annual public expenditure reviews), the GoT is confident that its development partners will maintain their support and fully implement their commitments under the Monterrey Consensus to enable Tanzania's attainment of the MDGs.

Structural Issues

Strong macroeconomic policies and sustained implementation of a broad range of structural reforms laid the foundations of Tanzania's economic growth. Reforms undertaken by the GoT to create a conducive environment for private sector investment include trade liberalisation, export promotion, maintaining a competitive exchange rate, streamlining of the exchange and payment system, financial sector liberalisation, fiscal policy reform, and liberalisation of the domestic market. Prior to these reforms, Tanzania's business environment was unfavourable to private investors, with an inadequate infrastructure, notably for transport, obsolete regulations and a heavy-handed administration. However, in recent years, the GoT has made significant progress in enhancing the business environment, especially through the implementation of a programme called the Business Environment Strengthening in Tanzania (BEST). Another significant step was the establishment of the Tanzania Investment Centre (TIC) in 1997 as a one-stop-centre promoting investment. More recently, the Banking and Financial Institutions Act was amended in 2003 to empower the BoT to regulate and supervise the activities of all savings and credit associations as well as to facilitate the provision of long-term finance to the productive sector, e.g. by allowing housing finance companies. The Tanzania Bankers Association has also improved access to credit through the establishment of a credit bureau. The Land Act of 1999 has been amended to accelerate land surveys and to modernise the land registry in order to enable the commercialisation of land leases and to facilitate their use as collateral for bank loans. Further initiatives are underway to formalise personal property rights with the overall aim of creating a comprehensive and inclusive property system that links with Tanzania's traditional norms and creates an institutional bridge that overcomes registration obstacles. In addition, measures to facilitate the speedy and effective enforcement of commercial contracts will be undertaken. Finally, the Income Tax Act of 2004 has been considered to be friendlier to private sector growth than previous income tax laws.

As in many developing countries, small firms predominate in the domestic private sector, with a particularly important role in employment creation. Based on the Central Register of Establishments (CRE) of October 2003, there were 13 442 enterprises with at least five employees, of which 5 905 enterprises (43.9 per cent of the total) employed five to nine persons, 5 559 enterprises (41.4 per cent of the total) had 10-49 employees, 936 enterprises (7 per cent of the total) had 50-99 employees, 339 enterprises (2.5 per cent) employed 100-199 people, 512 enterprises (3.8 per cent of the total) had 200-499 employees, and 191 enterprises (1.4 per cent of the total) employed more than 500 persons[6]. It is estimated that about a third of Tanzania's GDP originates from SMEs.

The promotion of SMEs has a long history in Tanzania. The first major attempt to promote SMEs was undertaken in 1966, when the National Small Industries Corporation (NSIC) was formed under the National Development Corporation (NDC). The NSIC set up small industrial clusters which were basically training-cum-production workshops. In 1973, the Small Industries Development Organisation (SIDO) was established by an Act of Parliament to plan, co-ordinate, promote and offer every form of service to small industries. Currently, SIDO remains the main government arm for promoting SMEs in Tanzania. Some of the key measures employed by SIDO included: *a)* the construction of 16 industrial estates with more than 140 sheds at regional headquarters; *b)* the establishment of 10 training-cum-production centres that offered simple rural-based technologies; *c)* the introduction of lease-purchase programmes through which more than 2 000 entrepreneurs were assisted with machines and working tools; and *d)* the setting-up of feasibility studies. In collaboration with other stakeholders, SIDO supported the establishment of SME associations to empower the private sector, whereby the Tanzania Food Processors Association (TAFOPA) and the Tanzania Small Industries Organisation (TASISO) are likely the two most prominent associations.

In April 2003, after a five-year preparation process involving extensive participation of the private sector, the GoT adopted, under the leadership of the Ministry of Industry and Trade, a comprehensive SME Development Policy. The SME Development Policy focuses on three main areas: *a)* the creation of a supportive business environment; *b)* development of an financial and non-financial services; and *c)* creation of an appropriate institutional infrastructure. The SME Development Policy takes into account the special constraints and opportunities faced by SMEs and aims to strengthen institutions that will address these constraints.

In addition, the government has adopted a variety of tax reforms to improve the business climate and to create a propitious environment for the growth of small- and medium-size enterprises. Currently, SMEs with an annual sales turnover of less than about $20 000 pay two types of taxes to the Tanzania Revenue Authority (TRA): a stamp duty on receipts and a presumptive income tax. These taxes are assessed on the basis of value of sales. In order to reduce compliance costs for such businesses, it is proposed to abolish the stamp duty on receipts, and increase the presumptive income tax rates to compensate partly for the resulting loss of revenue. The proposed new presumptive income tax is progressive with five rates, distinguishing between enterprises that keep and do not keep sufficient records to demonstrate turnover. Apart from reducing the overall tax burden, this system will provide incentives for better record keeping among small businesses, thereby improving their access to credit. Furthermore, if the small individual businesses keep records on income and expenses to a standard satisfactory to TRA, they will file returns and be assessed on their profits rather than their turnover. A variety of nuisance taxes such as license fees have been abolished, while other taxes have been harmonised.

The GoT has set up a variety of funding mechanisms for SMEs. Such funds include SIDO's traditional regional revolving fund (ERRF), the National Entrepreneurship Development Fund (NEDF), the Youth Development Fund (YDF), and the Women's Development Fund (WDF). Related programmes established through joint

5. Based on Tanzania's classification, small enterprises are categorised as enterprises that employ between five and 49 employees or with capital investment from Tsh5 million ($5 000) to Tsh200 million ($200 000). Excluding micro-enterprises, the share of small enterprises in total enterprises is 85 per cent. Medium enterprises are categorised as companies employing between 50 and 99 employees or with capital investment from about $200 000 to $800 000. Though more than 10 years old, the latest Informal Sector Survey estimated that there existed about 2 million micro-enterprises (i.e. enterprises with fewer than five employees), employing about 3 million people (mostly family members) in the informal sector.

GoT-donor efforts include the Small Entrepreneurs Loan Facility (SELF), the National Income Generating Programme (NIGP), the Presidential Trust Fund (PTF), and the Community Development Trust Fund (CDTF). The establishment of the National Microfinance Bank (NMB) was another key initiative, meant to cater specifically for microenterprises. Last but not least, a SME's Credit Guarantee Scheme has recently been established. Box 1 provides more details on the key initiatives supporting the financing of SMEs in Tanzania. Based on a recent survey, micro-credit accounts for almost 5 per cent of all bank credit. The main providers were savings and credit co-operatives and associations, microfinance NGOs, and a few commercial banks. The reforms of the banking sector, especially the amendments to the Land Act, the strengthening of the Commercial Court, the establishment of credit guarantee schemes, and improvements in infrastructure, are expected to further increase competition and access to credit, including for SMEs.

Tanzania has also made progress in restructuring and privatising public enterprises, even though the expected privatisation revenues to the amount of about $17 million were not fully realised during FY 2003/04. The GoT projects revenues of about $10 million in FY 2004/05 from the sale of government shares. The delays in the sale of publicly-owned companies were mainly due to a change in strategy. The new strategy is to restructure and reorganise the publicly-owned enterprises in order to make them more profitable and more sustainable before selling them, as well as to set up regulatory authorities and amend laws establishing the newly privatised enterprises. Such steps are essential given that Tanzania is now privatising large public utilities. In 2003, a total of 101 enterprises were concerned, with the sale of 26 whole enterprises and 75 non-core assets, bringing the cumulative total of the privatisation programme in December 2003 to 289 whole enterprises privatised and 328 non-core assets sold. The GoT also: *a)* completed the leasing arrangement of Dar es Salaam Water and Sewerage Authority (DAWASA); *b)* reached tendering stage of the leasing procedures of the Tanzania Railway Corporation (TRC); and *c)* finalised the two studies for unbundling the Tanzania Electric Supply Company (TANESCO), including the completion of preparations for a new electricity and energy marketing system as well as supervising the implementation of management contracts. The privatisation process has also begun for the National Insurance Company (NIC), the National Microfinance Bank (NMB), and commercial units of the Tanzania Harbours Authority (THA). Furthermore, the GoT initiated preparations for the privatisation of large farms such as the National Agricultural and Food Corporation (NAFCO), a variety of national ranches, and 12 cashew nut processing factories. The GoT continued to encounter challenges in the implementation of the privatisation programme. In particular, some public enterprises had excess workers requiring labour shedding, and some of the investors failed to restructure or delayed restructuring of the acquired enterprises. The GoT has taken the following measures to deal with the problems encountered: *a)* follow-up of the performance of the privatised enterprises in collaboration with the respective ministries and Parliamentary Committees; *b)* engagement of debt collectors to deal with chronic debtors; *c)* continuation of education of various stakeholders on the privatisation policy through workshops, media, leaflets and advertisements; *d)* establishment of a procedure of securing bank guarantees for the purpose of regulating brokers and investors who are not genuine; *e)* opening up of cases against investors who have failed to abide by the privatisation sale agreements; *f)* engagement of lawyers to deal with ongoing court cases; and *g)* employment of a land expert to deal with problematic title deeds.

The GoT continues to adhere to the objectives of the National Debt Strategy in the management of debt and continues to comply with the requirements of the Loans, Grants and Guarantees Act of 1974 which was amended in 2003. At present, loans are solicited from concessional sources only and directed to support priority sector spending for economic growth and poverty reduction. The issuance of government guarantees for contracting external loans has been stopped and it is now prohibited for any official or government agency to either borrow on behalf of the GoT or to enter into any arrangement of a financial nature without first obtaining the approval of the Minister for Finance,

Key Initiatives Supporting the Financing of SMEs in Tanzania

There are three key initiatives in Tanzania aimed at financing SMEs: the Small Industries Development Organization (SIDO), the National Microfinance Bank (NMB), and the newly-established SME Credit Guarantee Scheme.

a) Small Industries Development Organisation (SIDO)

Established in 1974, SIDO remains the main government arm for promoting SMEs in Tanzania. In addition to broad-based support for SMEs, including the establishment of training-cum-production centres and SMEs associations, SIDO also extends loans to SMEs through a regional revolving fund and the National Entrepreneurship Development Fund (NEDF). Group lending has been a major reason for the NEDF's success. The programme started with about $0.5 million of capital in 1994/95 and an additional 0.3 million in 1997/98, but has grown over the years and was able to expand its capital base to well over $1 million by early 2004, due to a reasonable repayment record. SIDO loans under the NDEF range between $50 and $500. The repayment period for individual borrowers is usually a minimum of one year and a maximum of two years. Repayments by small borrowers are usually on a monthly basis, though microenterprises are often required to pay through their groups on a weekly or fortnightly basis. It should be mentioned that there are a few other government established funds, including the Women Development Fund (WDF) managed by the Ministry of Community Development, the Gender Affairs and Children and the Youth Development Fund (YDF) under the Ministry of Youth Development and Sports, and the Small Entrepreneurs Loan Facility (SELF) under the Vice President's Office, Poverty Eradication Department (which is funded by a variety of donors), though they are much smaller than the NEDF.

b) National Microfinance Bank (NMB)

The government-owned NMB was formed in October 1997, after splitting from the former National Bank of Commerce, in order to provide banking services to poor individuals, micro-enterprises, savings and credit co-operative societies and associations, and community banks. In 2004, it provided a variety of micro and personal loans as well as savings, deposit, and payment services to more than 131 000 clients through 108 branch locations countrywide. The NMB maintained an outstanding loan portfolio of about $61.3 million in 2004. It has been under private management since 1999, and is on track to be privatised in 2005. It should be mentioned that a few other commercial banks (such as CRDB Bank, Akiba Commercial Bank, and the Tanzania Investment Bank) have also been extending loans to SMEs through savings and credit co-operative societies and associations, though their portfolio for SMEs is much smaller than that of the NMB.

c) SME Credit Guarantee Scheme (SME-CGS)

The objective of the SME Credit Guarantee Scheme (SME-CGS) is to kick-start financing to SMEs by the banking sector, while complementing and strengthening existing banking facilities. Participating financial institutions will maintain responsibility of credit scoring, approval, monitoring and recovery. The Bank of Tanzania will initially manage the scheme. Guarantee will be limited to 50 per cent of any loan. The size of the Fund is modest to start (Tsh2 billion, equivalent to $2 million). Loans have a maturity of one to five years and a maximum size of about $0.2 million. Though funds for the scheme had already been provided in the budget of FY 2003/04, it is expected to be launched and operational in the first half of 2005.

who in turn must consult with the National Debt Management Committee established under the Act.

Finally, while agricultural implements and inputs such as tractors, pesticides and fertilisers are exempted from customs duties, the remaining customs tariff structure has been changed following the coming into force of the East African Customs Union (EACU) on 1 January 2005. These changes include elimination of customs tariffs on goods originating from East African Community (EAC) states on a phased basis and introduction of a common external tariff on goods originating outside the EAC. Principles and procedures relating to customs will be harmonised across EAC states, although each member state will continue to administer and collect the customs duty. Tanzania is expected to earn new revenues of about $6 million in 2004/05 from the adoption of the EACU, while the abolition of duties due to the adoption of the EACU is expected to reduce other revenues by about $4.8 million in FY 2004/05.

Political and Social Context

Though some political unrest occurred towards the end of 2004 (related to local government elections in November 2004 and the upcoming national elections scheduled in October 2005), Tanzania continues to be one of the most politically stable countries in Africa. However, Zanzibar harbours a potential source of political unrest. In line with the PRSP and the National Anti Corruption Strategy and Action Plan (NACSAP) for 2003-05, the GoT continued with its efforts to promote good governance in the public service delivery, to strengthen the judicial system, and to curb corruption. Progress in the fight against corruption is being publicised in quarterly progress reports. Human and financial resource capacities to co-ordinate and implement the NACSAP are being addressed under the Public Service Reform Programme (RSRP). A Good Governance Co-ordination Unit (GGCU) has been established in the President's Office. The unit commissions studies on public procurement, public finance, as well as legal and judicial operations. The GoT continues to implement its salary payment reform policy for civil servants, which will permit it to reach the budgetary target limit of 4.8 per cent of GDP for wages. Furthermore, the GoT is expected to finalise soon a specific framework for processing salary adjustment arrears, including those for teachers. Payment of these arrears was suspended on account of fraud that was uncovered a year ago involving a few dishonest civil servants. Investigation has been almost completed and legal action is underway against the perpetrators. Moreover, the Large Taxpayers Department under the Tanzania Revenue Authority has been strengthened, leading to greater efficiency and a substantial reduction in complaints from such taxpayers.

The GoT has also taken a number of measures to improve the accountability of public funds and to strengthen the internal auditing function. Also, as part of the Public Financial Management Reform Programme (PFMRP), amendments to the Public Procurement Act No. 3 of 2001 are underway, with a view to improving efficiency in the implementation of the government budget, especially the execution of development projects. Due to all these efforts, Tanzania made considerable progress in reducing the perception of corruption. The October 2004 Report by Transparency International ranked Tanzania 90 (out of 146 countries), a better ranking than its neighbours (including Kenya and Uganda) and most other countries with similar GDP per capita levels.

Previously established specialised government agencies, such as the Ethics Secretariat, the Commission of Human Rights and Good Governance, and the Prevention of Corruption Bureau (PCB), continue to report quarterly on matters brought to their attention. The Commission for Human Rights and Good Governance has also conducted meetings with government officials to enlighten them on the workings of the Commission and met with civil society organisations that are engaged in the promotion of human rights. The PCB has been strengthened by increasing its budget and by decentralising from administrative zones to regional and district offices. Yet, it has become clear that there is need for further action to ensure efficiency, transparency and accountability in law enforcement institutions. The

2004 USAID Country Report notes that Tanzania's democracy remains fragile. While there are clear policy statements and enabling legislation has been enacted to move forward with the local government reform programme, implementation of the reforms to date has been slower than anticipated, largely due to an over-ambitious mid-term plan with overlapping implementation phases.

Tanzania has completed three years of implementing its first Poverty Reduction Strategy Paper (PRSP-I) and has concluded a revised PRSP, the *National Strategy for Growth and Reduction of Poverty (NSGRP)* in November 2004, focusing on poverty reduction measures which aim at attaining three pillars of success: good governance and accountability; growth and reduction of income poverty; and improved quality and social well-being[7]. Yet, Tanzania remains one of the poorest countries in the world. Per capita income in 2004 is estimated to be about $290 and, owing to AIDS/HIV, life expectancy at birth has dropped from 50 years in 1990 to 43 years in 2002. There is some indication that outside Dar es Salaam, there has been little progress in the reduction of the proportion of households below national poverty lines. The picture is the same for food poverty. While considerable progress has been made in terms of increasing the shares of budget allocations for poverty reduction measures, actual outputs, especially in terms of life expectancy and child mortality are disappointing. Comparing the progress made in reducing poverty with other countries in terms of Tanzania's ranking in the United Nations Development Programme (UNDP) Human Development Index (HDI), Tanzania has experienced a slight deterioration in its rank, going from a ranking of 140 (out of 162 countries) in 2001, to a ranking of 162 (out of 177 countries) in 2002[8]. Given the incomplete transition from macroeconomic achievements to the micro-level reforms, it is recognised that there is need for closer analytical work on growth-poverty linkages and how growth could better benefit the poor. HIV/AIDS and malaria have also contributed to the disappointing outcomes. Malaria continues to be the number one killer disease, accounting for 17 per cent of all deaths and approximately 30 per cent of all hospital visits. The HIV/AIDS adult prevalence rate has increased slightly from 7.8 per cent in 2001 to 8.8 per cent in 2003. The GoT continues to fight the spread of HIV through the recently developed National Multi-Sectoral Strategic Framework (NMSF) which intends to address HIV in a comprehensive manner to overcome some of the previous weaknesses in efforts against HIV.

The UNDP 2004 has ranked Tanzania 131 out of 144 countries in its Gender Development Index (GDI) quantifying the status, treatment and participation of women, roughly as poor as the HDI ranking. Yet, in terms of women's participation in economic and political life, Tanzania fares relatively well. For example, looking at the percentage of seats in parliament held by women, Tanzania ranks 34 (out of 163 countries) with 21.4 per cent of seats held by women. With regards to the ratio of female-earned-income to male-earned-income, at 71 per cent Tanzania ranks 8 out of 153 countries. While life expectancy decreased drastically during the last 10 years (owing to HIV/AIDS), life expectancy has decreased more for women than for men. Tanzanian women still live about one year longer than Tanzanian men, however.

The current health sector reform plan aims to improve primary health care delivery through decentralisation of responsibilities to the district level, thus favouring rural areas. Decentralisation is intended to improve service quality, availability, and accessibility. According to the latest Household Budget Survey (2000/01), 91.4 per cent of the population are less than 10 km from a health facility and 75.4 per cent are less than 6 km away. The GoT is using User Satisfaction Questionnaires to monitor the perceived quality of the health services provided. For public facilities, some two-thirds of respondents did not report a problem, while one third did. The most common complaints were about long waiting times and a shortage of drugs. With immunization rates for tuberculosis, diphtheria and measles around 90 per cent, Tanzania compares

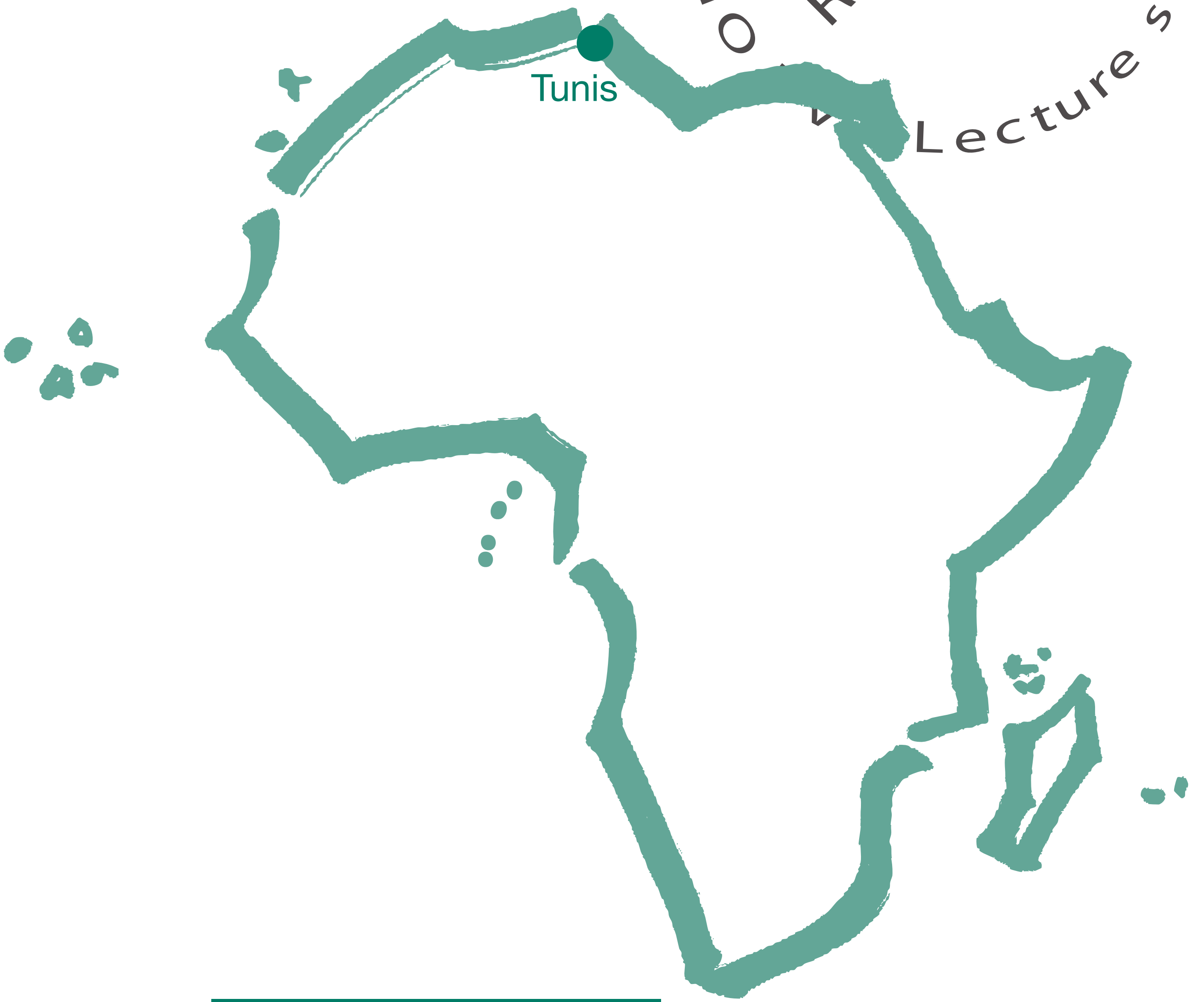
7. More information on poverty reduction initiatives in Tanzania can be obtained at: www.povertymonitoring.go.tz

8. See UNDP (2002), and UNDP (2004), *Human Development Report*, New York respectively.

favourably to other sub-Saharan countries and continues to make progress towards universal coverage. More quantitative data on progress made in the health sector is expected from the analysis of the recent Population and Housing Census.

After a period of virtually stagnant enrolment ratios in the late 1990s, there have been large gains in primary enrolment in the past three years. Based on the Ministry of Education and Culture's (MoEC's) Basic Education Statistics, the gross enrolment ratio for primary education has increased from 78 per cent in 2000 to 85 per cent in 2001, to 99 per cent in 2002, and to 105 per cent in 2003. Similarly, net enrolment ratios have increased from 59 per cent in 2000, to 66 per cent in 2001, to 81 per cent in 2002, and to 89 per cent in 2003. While the gap between primary school enrolment ratios between boys and girls has been widening over the last four years, amounting to about 3 per cent for the net enrolment ratios of 2002 and 2003, it is anticipated that this gender gap will disappear in the next few years. The largest increase in overall enrolment ratios has come with the abolition of education fees in 2002 and the launch of the Primary Education Development Plan (PEDP) 2002-06. Yet, pass rates in the Primary School Leaving Examination (PSLE) taken in Standard 7 remain low, though transition rates from primary to secondary school have increased from 16 per cent in the late 1990s to about 20 per cent in 2002/03

Tunisia



key figures

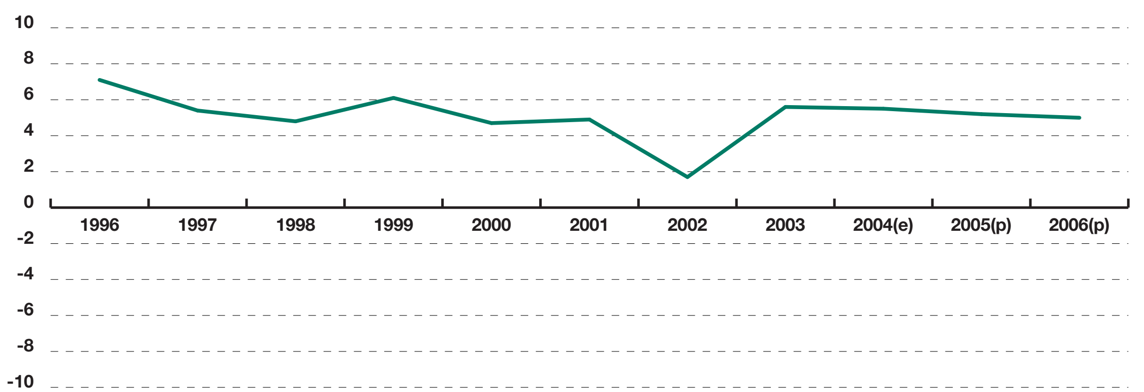
• Land area, thousands of km²	164
• Population, thousands (2004)	9 937
• GDP per capita, $ (2003)	2 543
• Life expectancy (2000-2005)	72.8
• Illiteracy rate (2004)	24.8

BETWEEN 1999 AND 2004, reforms undertaken in Tunisia were chiefly aimed at preparing for opening to the world economy, encouraging diversification and increasing competitivity. These enabled the country to adapt to a difficult international environment and to survive three consecutive years of drought. In 2003, good performances in agriculture and tourism accelerated growth from 1.7 per cent (2002) to 5.6 per cent. According to estimates, this should reach 5.5 per cent in 2004 and over 5 per cent in 2005 and 2006, primarily driven by tourism and exports to the European Union (EU), furthered by the depreciation of the dinar *vis-à-vis* the euro.

Despite these positive results, efforts to encourage private investment, notably in sectors such as clothing and textiles, must be continued in order to meet future national and international challenges (such as the implementation of the free trade area with the EU in 2008). In order for Tunisia to consolidate its achievements and benefit from the advantages of opening its economy, several goals are key. These include reducing unemployment, improving commercial access to credit, reducing economic distortions and improving administration.

Opening to the world market raises challenges of diversification economic competitivity.

Figure 1 - **Real GDP Growth**



Source: Budget data; estimates (e) and projections (p) based on authors' calculations

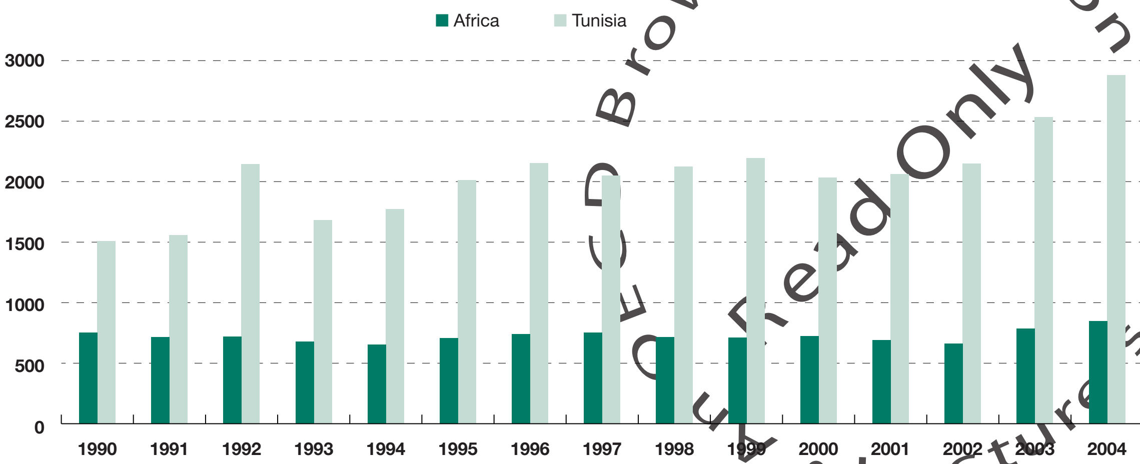
Recent Economic Developments

After a disappointing 2002 (with growth at just 1.7 per cent), the growth rate returned to its five-year average in 2003 (5.6 per cent). In real terms, excluding agriculture and fishing, growth has remained practically stable at 3.6 per cent in 2003 against 3.5 per cent in 2002. Real growth is estimated at 5.5 per cent in 2004 and should reach 5.2 per cent in 2005. Excluding agriculture, it should reach 5.4 per cent in 2004 and 6.3 per cent in 2005.

In 2004, both agriculture and fisheries, which account for 14 per cent of GDP, registered good performances with real growth of 9 per cent, compared to 21.5 per cent in 2003.

Progress in 2004 is primarily due to favourable weather conditions, which resulted in an increase in the production of dates, apricots, peaches, plums and pomegranates in 2003/4. Olive oil production also more than doubled to 280 000 tons during the same season. The agricultural sector's growth, however, was

Figure 2 - **GDP per Capita in Tunisia and Africa** (current $)



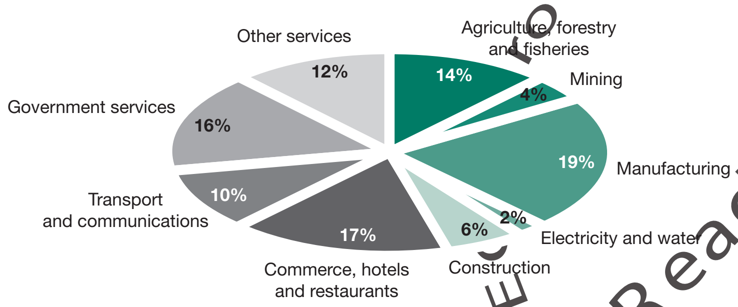
Source: IMF.

hampered by a less impressive performance of livestock: the number of breeding cattle and sheep fell by 14 and 2 per cent respectively, despite improved vegetative cover in pastures and increased fodder production (around 85 per cent). Though heavy rain and hail caused damage in June 2004, the cereal harvest is estimated at 24 million quintals in 2003/4, down by 17 per cent in volume and by 20 per cent in value over the previous year. However, the Tunisian authorities expect a significant fall in real growth in agriculture and fishing in 2005, which could be –9 per cent.

Agriculture and fishing are still of great economic, social and environmental importance in Tunisia. The authorities thus continued to support the sector's development in 2004, particularly by promoting the modernisation of farming methods and management, strengthening technical know-how and exploitation and implementation of scientific research carried out in the field. A study of regional agricultural maps, finalised in 2003, should help farmers to better target their activities by taking regional climatic and economic data into account. Measures to improve the working environment of agricultural companies and operations were also undertaken. These included strengthening and restructuring joint-trade organisations, bolstering agricultural supply and marketing bodies, intensifying cattle vaccination campaigns and reinforcing sanitary import controls to protect the national herd. The fisheries sector benefited from the ongoing strategy of modernising the fleet and reinforcing both port infrastructures and refrigeration equipment in 2004. This was pursued in tandem with a rationalisation of the exploitation of fishing resources, particularly in the Gulf of Gabes. Further, to support production and improve safety, a satellite surveillance programme of fishing activities was adopted in 2003 and new measures to regulate boat movements in the Gulf of Gabes were taken.

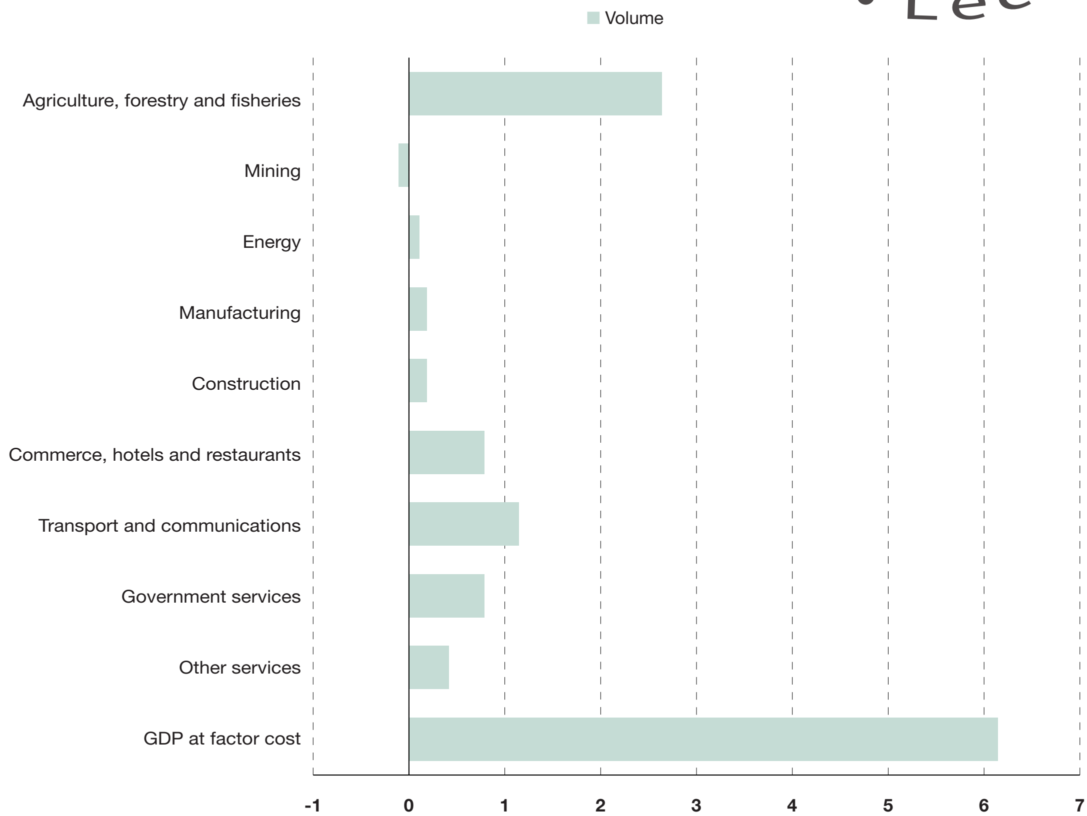
In the industrial sector, the government consolidated its efforts to improve the business environment by modifying the legal framework, improving human resources, developing infrastructure, stabilising the macroeconomic environment, restructuring the banking and financial system and modernising the administration. In parallel, the modernisation programme (*Programme de mise à niveau*) initiated at the beginning of 1996 was also continued, but the strictness of its financial eligibility criteria resulted in a low rate of spending. At the end of 2003, of the 2 818 companies applying to the programme, only 1 649 had been approved by the steering committee (*Comité de pilotage*, Copil). In all, 2 646 million dinars ($2 151 million) were invested. In the same token, and also at the end of 2003, 164 companies had benefited from the industrial services modernisation programme launched in February 2000. Of these, 65 had their applications approved leading to a total investment of 26 million dinars ($21 million), and state subsidies of 8 million dinars ($6.5 million).

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on budget data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on budget data.

Further, an EU-supported industrial modernisation programme (*Programme de modernisation industrielle*, PMI) was put in place. This five-year programme (2003-08) to assist industrial modernisation and restructuring in Tunisia targets the modernisation of companies. It is comprised of four main elements: development via innovation and creativity; reinforcing quality, metrology and standardisation; developing patent rights; and improving and facilitating access to financing for small and medium-sized enterprises (SMEs).

Despite these efforts, growth of the manufacturing industry – which went from 0.9 per cent in 2003 to nearly 4.3 per cent in 2004 – remains very uneven and varies according to sub-sector. While a few clearly improved over 2003 (food-processing, construction materials, chemicals, mechanical and electrical sector) owing to greater price competitivity, the largest sector – textiles/clothing/leather – experienced negative growth in 2004 (-1.5 per cent). This sub-sector should experience zero growth in 2005. The difficulties of the textile sector alone, which contracted by 1 per cent in 2004, pose serious problems for the Tunisian government. During the 1990s, the sector grew on average by 8 per cent in real terms per annum. This dropped to just 1 per cent during the 2001/03 period. With competition from Eastern Europe and Asia, which have lower labour and production costs, Tunisia is have difficulty maintaining its position as the fourth largest textile supplier to the European market. Structural problems remain large. In 2003, 17 factories were shut down, leading to the loss of approximately 8 000 jobs. Despite this stagnation, the sector continues to dominate the Tunisian manufacturing sector: in 2004, it accounted for approximately 2 000 companies, 280 000 jobs, a third of manufacturing production, 40 per cent of all exports and 6 per cent of GDP.

Non-manufacturing industries rebounded in 2004 after sluggish performances in 2003 (1.5 per cent, as opposed to 4.9 per cent in 2002), to reach 3.6 per cent. This was due to a 4.1 per cent growth in hydrocarbons and a 3.5 per cent growth in public buildings and works. This growth rate should be maintained in 2005.

In spite of increasing international competition, combined with ongoing geopolitical tensions and the April 2002 Djerba bombings, tourism performed well in 2004. The number of tourists increased by 17.3 per cent with 6 million visitors, compared to slightly more than 5 million the previous year. Overnight stays increased by 21.5 per cent in 2004, to 34 million, and the hotel occupancy rate reached 48.5 per cent, compared to 42 per cent in 2003. Tourism, which remains the leading source of foreign currency, generated revenue of 2.2 billion dinars in 2004 ($1.8 billion), against 1.9 billion dinars in 2003 – an increase of 17.7 per cent. The south, centre and coastal regions were the most visited, with tourists originating principally from Maghrebian countries (2.3 million in 2004), France (over 1 million, having increased by 22.5 per cent from 2003), Belgium and Spain. Domestic tourism developed strongly in 2004, to reach 2.8 million overnight stays, or 8.2 per cent of the tourism total.

The fall in Tunisia's share of tourism to the Mediterranean region reflects a level of fatigue in the sector. To assist its recovery, in addition to timely measures such as increasing the budget for promoting and marketing tourism, the Tunisian authorities are attempting to identify the structural levers capable of increasing the sector's competitivity. Elements being examined include hotel profitability, improving knowledge of tourist expectations and the demands of various sectors, differentiating products, improving the quality of facilities and diversifying ways for tourists to spend money. Promotional campaigns were carried out targeting the new markets of Eastern Europe (Poland, Czechoslovakia) and beyond (the United States, Japan, Russia). These began to bear fruit in 2004.

Partly due to the comparative increase in tourism, growth in the transport sector increased from 2.2 per cent in 2003 to 6.2 per cent in 2004. Similarly, the business sector also increased in 2003, with growth of 6.2 per cent.

In 2004, the continued growth in services led to it reaching 7.7 per cent in real terms, notably due to the good performance of the tourism and transport sectors. This trend should continue in 2005 with 9.7 per cent growth, driven by telecommunications (24 per cent), business (6.6 per cent) and transport (6.3 per cent). This should lead to an improvement in services contribution to overall growth, from 3.7 per cent in 2004 to 4.7 per cent in 2005.

Consumption fell, from 21.2 per cent in 2003 to 26.6 per cent in 2004 owing to increased domestic savings. Gross fixed capital formation (GFCF) contracted by –3.2 per cent in 2003, principally as result of a drop in investment in agriculture, fishing and energy. It continued to fall between 2003 and 2004, from 25 to 24.7 per cent, but should start to increase again in 2005 and 2006, to 25.6 per cent and 26 per cent of GDP. In 2004, the Tunisian authorities stepped up their

Table 1 - Demand Composition (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Gross capital formation	**25.1**	**27.9**	**25.7**	**25.0**	**24.7**	**25.6**	**26.0**
Public	4.7	7.8	7.5	7.4	7.1	7.5	7.7
Private	20.3	20.1	18.2	17.7	17.6	18.1	18.3
Consumption	**76.5**	**76.7**	**78.6**	**78.8**	**73.4**	**72.2**	**72.4**
Public	15.6	15.6	16.0	16.1	15.3	14.9	14.6
Private	60.9	61.1	62.6	62.8	58.1	57.3	57.8
External sector	**-1.6**	**-4.6**	**-4.3**	**-3.9**	**1.9**	**2.2**	**1.6**
Exports	42.1	47.7	45.2	43.8	48.5	50.6	50.4
Imports	-43.7	-52.3	-49.5	-47.6	-46.6	-48.4	-48.8

Source: Budget data; estimates (e) and projections (p) based on authors' calculations.

promotion of investments. In addition to the modernisation programme's measures, the activities of capital risk companies and their capacity to identify, evaluate and follow-up on projects was strengthened. The workings of the fund for industrial promotion and decentralisation (*Fonds de promotion et de décentralisation industrielle*, Foprodi) were revised and long-term savings (applied to investment financing) were encouraged through the introduction of favourable tax allowances for holders of share and investment savings accounts.

Macroeconomic Policies

Fiscal and Monetary Policy

In order to maintain budgetary balance, particularly in the framework of tariff dismantlement under the association agreements with the EU, the Tunisian authorities are focusing on accelerating the reforms to modernise and optimise the tax system.

Tax revenue, which comprises 85 per cent of the state's income, dropped in 2004 to 20.1 per cent of GDP. To contain the effects of the rise in the price of oil, in August 2004 VAT on diesel oil, "blue petroleum", fuel and liquid petroleum gas (LPG), was reduced from 18 per cent to 10 per cent. An additional 200 million dinars in funding was granted. Customs revenues continued to fall, though at a slower rate, going from 2 per cent of GDP in 2002 to 1.7 per cent in 2003 and 1.6 per cent in 2004. This resulted in the contribution of taxes to GDP remaining more or less stable in 2004, but this should fall in 2005, from 24.1 to 23 per cent of GDP.

In spite of the elections in 2004 and the political priorities (increasing competitivity, job creation, raising standards of living and continuing reforms), the government's efforts to reduce spending were effective. Budgetary spending was significantly decreased, going from 27.2 per cent of GDP in 2003 to 25.6 per cent in 2004. This contraction should continue in 2005 and 2006. Almost half of current expenditure went to social sectors (education, health). The remaining half was almost evenly divided between general services and the economic sectors. Interest payments on debt decreased, from 3 per cent of GDP in 2003 to 2.7 per cent in 2004.

If privatisation receipts are included, the budgetary deficit in 2004 was 1.5 per cent of GDP, compared to 3.2 per cent in 2003 and 1.9 per cent in 2002. The forecast deficits for 2005 and 2006 are 2.3 and 2.2 per cent respectively. Excluding privatisation income and grants, the 2004 deficit was much higher (2.8 per cent): privatisations accounted for 334 million dinars, compared to just 8 million in 2003.

The monetary policy adopted by the Tunisian authorities in 2004 pursued the same objectives as the preceding years, i.e. restructuring the economy, controlling inflation, and maintaining stability in the real exchange rate. Reflecting the upturn in the

Table 2 - Public Finances (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**30.6**	**24.3**	**25.9**	**24.0**	**24.1**	**23.0**	**23.0**
Tax revenue	25.0	21.7	22.6	20.7	20.1	20.1	20.3
Grants	0.2	0.3	0.4	0.2	0.2	0.3	0.2
Total expenditure and net lending[a]	**35.5**	**27.8**	**27.8**	**27.2**	**25.6**	**25.3**	**25.2**
Current expenditure	28.1	19.7	20.0	19.6	18.6	18.0	17.7
Excluding Interest	*23.8*	*16.6*	*17.0*	*16.6*	*15.9*	*15.5*	*15.3*
Wages and salaries[a]	10.3	11.8	12.2	12.2	11.6	11.1	10.8
Interest	4.3	3.1	3.0	3.0	2.7	2.5	2.4
Capital expenditure	6.9	7.7	7.5	7.2	6.9	7.3	7.5
Primary balance	**-0.5**	**-0.4**	**1.1**	**-0.2**	**1.2**	**0.2**	**0.3**
Overall balance	**-4.9**	**-3.5**	**-1.9**	**-3.2**	**-1.5**	**-2.3**	**-2.2**

a. Only major items are included.

Source: IMF data; estimates (e) and projections (p) based on authors' calculations

economy in 2004, money supply (M3) grew by nearly 2.5 percentage points (9.3 per cent against 6.8 per cent in 2003), while liquidity (M3/GDP) dropped, from 60.3 per cent in 2003 to 54.1 per cent in 2004. The growth in money in circulation is as much due to the increase of money supply as to the development of quasi-money. On the opposite front, net foreign debt increased by 15.5 per cent in 2004, consolidating the trend perceived since 2001. In 2004, lending to the economy increased by 7.7 per cent, compared to 6.2 per cent in 2003. Deposit banks dominate financing to the economy. The decline in the state's net debt, already observed in 2002 and 2003, was underlined in 2004, falling by 8.6 per cent for the second consecutive year.

The financial market improved slightly, with two indices Tunindex and BVMT reflecting growth of 6.5 per cent and 3.7 per cent respectively throughout 2004. While stock market activity increased by 8 per cent in the first quarter of 2004, the second quarter was less convincing.

Having been maintained at its 2002 level in 2003 (2.7 per cent), inflation increased to 3.5 per cent in 2004. With increased household consumption – aided by higher salaries and an improved employment context – and a 5 per cent rise in oil product prices in February 2005, inflation should reach 3.2 per cent in 2005, before falling again to 2.2 per cent in 2006.

The value of the dinar fell against the euro and increased against the dollar. Over the course of 2003, the dinar fell by 7.9 per cent against the euro, though it rose against the dollar, yen and pound sterling by 10.4, 2.2 and 1.4 per cent, respectively. In 2004, the dinar rose again *vis-à-vis* the dollar, by 1.6 per cent, and fell by 6.4 per cent against the euro.

External Position

In 2004, though liberalisation continued, trade remains protected and it is imperative to accelerate the reduction of tariffs on goods from outside the EU and to dismantle import monopolies of goods such as drugs, cereals, coffee and tea before liberalisation is complete. The most favoured nation (MFN) tariff is still significant and the gap between the preferential rights applied to EU imports is large. In 2003, the average MFN tariff was 28.6 per cent (35.9 per cent in 2000), compared to a tariff on EU goods of 24.3 per cent. The difference is even more pronounced for non-agricultural products. Liberalisation of services is still limited, in spite of Tunisia's adherence to the tourism, financial/business services and communication commitments of the World Trade Organization (WTO). On the whole, market opening is taking place slowly.

Aside from the association agreements with the EU – Tunisia's largest trading partner[1] – which will gradually alleviate trade barriers by 2008, Tunisia signed a number of other agreements: with Turkey, to establish a free-trade area by 2015; with Egypt, Jordan and Morocco, to develop a free-trade area by 2005 under the Agadir Agreement; and with the United States, the TIFA (Trade and Investment Framework Agreement), a mechanism for encouraging free trade between the two countries. However, the end of the Multi-Fiber Agreement (MFA) on 1 January 2005, and increased competition from Asian countries in the sector, forced Tunisia and the EU to adopt a number of measures. In effect, the end of the MFA risks translating into a significant reallocation of production to more competitive countries, and to a loss of several thousand jobs. In 2004, the WTO estimated that the end of the MFA would increase China's share of the European textile and clothing import market from 10 to 12 per cent, and India's share from 9 to 11 per cent. Within five to ten years, 50 000 Tunisians will lose their jobs in the textile sector. To contain the problem, the EU pushed forward implementing free circulation of raw textiles in all Mediterranean developing countries and Tunisia has undertaken some structural reforms, including greater co-operation with the Euro-Mediterranean countries.

The external position of the economy improved markedly in 2003, demonstrated by the positive balance of payments. In spite of a difficult international climate, this more than doubled to 383 million dinars (146 per cent of GDP), compared to 140 million dinars in 2002. This sizeable increase is partly the result of a contraction in the current deficit, from 3.5 per cent of GDP in 2002, to 2.9 per cent in 2003 and to 2.1 per cent in 2004, specifically owing to a reduction in the trade deficit during 2002-04. However, after a fall in imports in 2004 – to 40.5 per cent of GDP from 41.2 per cent in 2003 – imports should begin to increase again in 2005 (42.1 per cent of GDP) and in 2006 (42.4 per cent). This will exacerbate the trade deficit, which should be 9.6 per cent of GDP in 2005 and 10.6 per cent in 2006. The performance of imports in 2004 is largely explained by imports of non-food consumer goods and energy: +15.5 per cent increase in machinery and +20.2 per cent for raw and semi-finished materials. Tunisia is a net importer of oil, as its production (3.3 million tons equivalent in 2004) supplies only 46 per cent of annual needs. Nonetheless, the value of energy product imports advanced slower than exports, permitting a reduction in the energy deficit from 423.6 million dinars in 2003, to 406.1 million in 2004.

In 2004, exports as a proportion of GDP fell slightly (to 31.3 per cent, versus 32.1 per cent in 2003), but since the end of the 1990s, it has generally been above 30 per cent of GDP. Agricultural and food processing exports rose quite significantly (by 83 per cent) over 2003, accounting for 11.4 per cent of all exports in 2004, compared to 7.3 per cent in 2003. The textile sector fell however, from 47.1 per cent of exports in 2003 to 42.4 per cent in 2004.

Net foreign currency reserves increased to $3.2 million in 2004, compared to 3 million the previous year; they covered around 2.9 months of goods

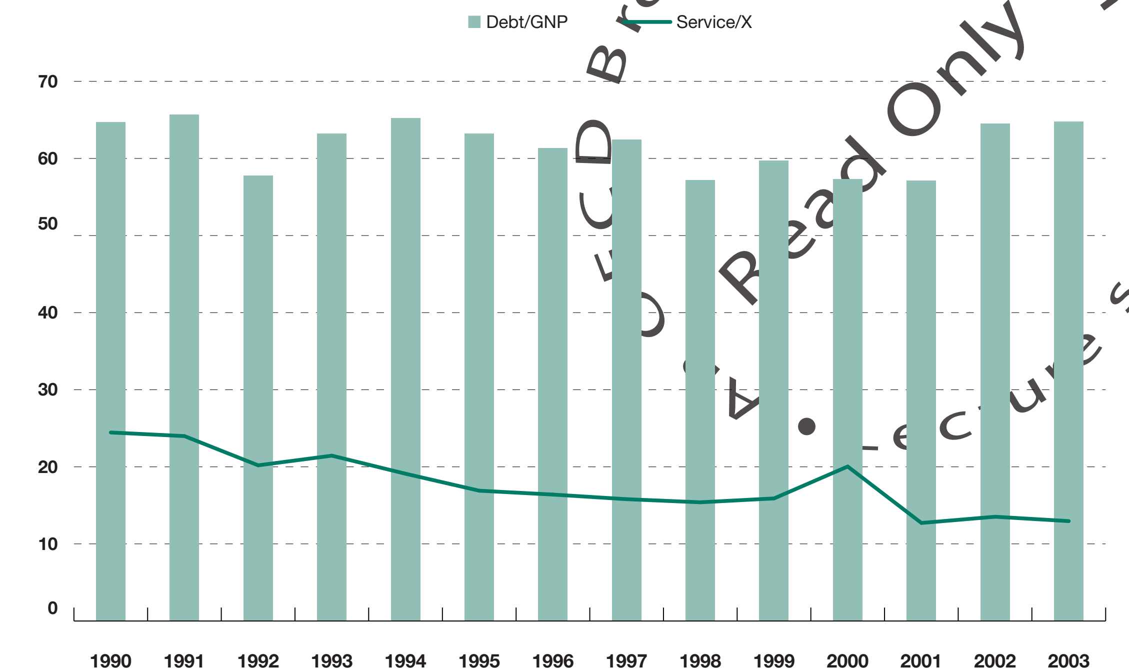
Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-9.0	-11.8	-10.1	-9.1	-9.1	-9.6	-10.6
Exports of goods (f.o.b.)	28.2	33.2	32.6	32.1	31.3	32.5	31.8
Imports of goods (f.o.b.)	-37.2	-45.0	-42.7	-41.2	-40.5	-42.1	-42.4
Services	9.6	7.4	5.9	7.3			
Factor income	-5.3	-0.2	0.3	-4.4			
Current transfers	2.2	0.4	0.3	3.4			
Current account balance	**-2.6**	**-4.2**	**-3.5**	**-2.9**			

Source: IMF data; estimations (e) and projections (p) based on authors' calculations.

1. In 2004, the EU accounted for 81 per cent of Tunisia's exports and 71 per cent of its imports.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

and services imports.

External debt stock slightly increased, to $14.4 million at the end of 2004, against 14.3 million at the end of 2003. This represented a 6-point percentage fall against GDP (51 per cent versus 57 per cent in 2003). The debt service ratio expressed as a percentage of current income, increased between 2003 and 2004, from 15.1 to 19 per cent.

Structural Issues

In spite of the country's good economic performances, structural reforms are of particular importance: in the context of strong international competition, these are aimed at supporting the business environment and improving overall competitivity in various sectors. Generally speaking, these reforms are advancing slowly.

In comparison with other high-growth countries, Tunisia has a structural deficit of private investment, in spite of having a generous incentive system and measures targeted for export activities and establishing offshore companies. Several steps have been taken to reduce business costs (shortening registration delays, reducing customs procedures and documents, simplifying foreign-business regulations, etc). The government also sponsored several funds to support lending to SMEs and emerging enterprises and it put in place a regulatory framework for developing capital risk.

Strengthening the investment climate nonetheless requires improving regulatory transparency and predictability as well as market contestability, and reducing barriers to entry in services (transport and new technologies, especially information and communications). The state's strong interference in business strengthens the positions of insiders, thus discouraging other entrepreneurs from taking risks.

In 2004, the World Bank pointed out the weak role of SMEs in job creation, particularly in highly qualified sectors, and this persists although recruiting procedures are much more flexible than redundancy ones. The high number of non-performing loans in the banking system reduces SMEs' access to credit even if initiatives such as micro-credit could enable the formation of new companies in employment-creating sectors. In order to meet some of the demand for jobs, the state has set a goal of having 70 000 new SMEs within five years (2004-09). An SME financing bank was created in 2004 with a capitalisation of 50 million dinars and effectively launched in 2005. Working in partnership with credit institutions, its mission is to facilitate the creation of SMEs by financing projects, participating in company capital, expansion operations and pledging guarantees.

Micro-credit in Tunisia operates through two axes: public institutions and programmes, and the activities of various NGOs, which has recently boomed. On the public front, without a doubt, the largest organisation is the *Banque tunisienne de solidarité* (BTS).

Begun in 1992, the urban development programme (*Programme de développement urbain intégré*, PDUI) and its equivalent for rural areas, the PDRI (*Programme de développement rural intégré*) became involved in micro-credit activities, among other things. These two programmes, whose aim is to improve living conditions and fight poverty in their respective areas, financed businesses by granting loans at 6 per cent (to underwrite 70 per cent of project costs) and subsidies (for the remaining 30 per cent). Entering its final phase, the so-called second generation of PDRI support led to no less than 941 small projects and 13 000 small farm improvement projects being financed. The scale of investment was 267 million dinars ($217 million). At the end of 2004, the PDUI was responsible for the creation of 6 604 projects. On the other hand, it had intervened to reinforce 557 projects and had contributed to the working capital of 2 239 projects in 32 different villages throughout the country.

The legal and regulatory framework of micro-credit organisations was laid out in an act of July 1999. This stipulated that their creation had to be approved by the Finance Ministry, advised by a consultative commission. Loans intended as aid and to increase economic and social integration by financing the acquisition of small machinery or essential intrants, or taking the form of working capital are considered "micro-credit". Loans can also be granted to improve living conditions. Those

The Banque tunisienne de solidarité

The *Banque tunisienne de solidarité* (BTS), which is 62 per cent owned by public shareholders, was created in 1997. Its principal aim is to grant loans to small developers lacking access to financing and guarantees. It is also charged with the task of intervening in underprivileged areas covered by the *Fonds de solidarité nationale* (FSN). Since January 2003, the BTS has also undertaken the management of the lending and micro-credit programmes of the national employment fund (*Fonds national de l'emploi*, Fonds 21-21), created in 1999. By 31 December 2004, BTS had granted 74 138 loans totalling 306 million dinars, and thus contributing to the creation of 106 793 jobs. Three categories of loans, aimed at reducing poverty by promoting jobs, exist: *i)* loans in underprivileged areas in which the FSN operates (15 771 loans, 86 per cent of which were for new projects, leading to 22 352 jobs); *ii)* loans granted in 119 job-creation priority areas [32 142 loans, of which 87.3 per cent were for new projects, leading to 47 125 new jobs (71 per cent for men, 41 per cent for the 30-39 year age bracket)]; *iii)* loans granted under the framework of the national employment fund, [22 081 loans, 95 per cent for new projects and 33 960 jobs (50 per cent for those with a secondary school education and 42 per cent to those between 18-29 years of age)]. These loans were granted with a maximum interest rate of 5 per cent per annum, but the system favours an individualised approach to setting lending conditions (amount, grace period and repayment period). It also provides for ongoing support of successful projects via further loans even before repayment. The regional distribution of BTS loans suggests that the authorities' action has been concentrated on the poorest areas, specifically in the north and centre-east.

eligible for micro-credit include those without salaried employment coming from needy families in vulnerable categories. These loans – of 2 000 dinars for revenue-generating activities and 500 dinars for loans intended to improve the quality of life – are granted at a maximum rate of 5 per cent and a term of not more than three years. Micro-credit associations are not empowered to take deposits. Instead, they must rely on funds put at their disposal: under the aegis of international co-operation through partnership agreements and programme contracts; on grants or public or private financial aid; on revenue from repaid micro-credit loans; and, from investment revenue. In order for these associations to have appropriate levels of transparency, they are obliged to keep regular accounts, to carry out internal audits of their accounts and must submit to the authority of the Finance Ministry. Micro-credit organisations also benefit from certain tax advantages, specifically free loan contract registration and exemption from VAT on loan commissions and interest. In 2004, 81 organisations operated in the micro-credit sector, together financing 104 783 projects with an overall value of 79.276 million dinars ($64.462 million).

The reform of the financial sector was accelerated during the 2000-04 period, to cope with development needs and the expectations of the productive system, itself restructuring. However, new measures must be taken to open the sector to foreign competition, in accordance with agreements with the WTO and EU. For the moment, reforms have affected the banking, insurance and capital market sectors, aiming to make them capable of playing a more active role in both mobilising domestic resources and in financing investments geared towards more profitable activities. Begun in 1988 and strengthened in the mid-1990s, the first step in reforming the banking sector focused on liberalising financing within the sector. Banks were empowered progressively to determine resource remuneration and job yields. Furthermore, the sector's financial situation has improved with the reinforcing of prudential regulations. This strong stabilisation effort, which took place at the end of the 1990s, prompted nearly all banks to adhere to the programme. The result has been an increase in private funding of more than 80 per cent, respect for the solvency ratio (8.9 per cent), a tripling of the value of capital reserves and a marked reduction in unproductive assets. To support this effort, the state took over some long-term debts on public companies, implemented a suitable tax system and introduced various techniques for discharging balances, such as ceding loans to collection agencies, and cancelling totally irrecoverable debts. A new programme, initiated at the end of the 1990s by the Central Bank of Tunisia (BCT), aimed at following up on these results. It is comprised of several branches, including modernising the system of payments, improving the quality of financial information and adapting the legal environment to banking activity. An electronic balancing system of all bank transactions was put in place. The development of electronic money was furthered in 2001 with the issuing of a national payment card. The central information bank of the BCT is made up of eight databases: risk, unpaid cheques, personal financial statements and loans, economic information, listed assets, loans eligible for refinancing and debt ceded to collection agencies. Furthermore, and at the BCT's instigation, banks work together to develop their information systems. The revision of the banking law in 2001 sanctioned the principle of decompartmentalising activities and furthering the idea of a universal bank. This reconfiguration of the banking environment was completed in 2002 with the cession of a majority stake in the capital of the *Union Internationale de Banques* (UIB) to the French bank, *Société Générale*, the merger of two development banks with a public commercial bank, and the transformation of five other development banks into universal banks. Several other measures were also taken obliging banks to: implement internal control systems; provide recent ratings to non-publicly listed clients with bank investments of over 25 million dinars; obtain the certification of financial statements of clients with bank investments of over 5 million dinars by a legally empowered auditor; tighten risk sharing norms; and, install a new level of risk division.

In spite of this progress, non-performing loans continue to weigh heavily on the economy. They increased by 3 percentage points in 2003, to 24 per cent (5 million dinars) of banking credits. The *Banque du Sud* also failed to attract a buyer in 2004 and the public sector still holds the majority of assets in the banking sector.

Accelerated privatisation has increased the standing of the private sector in the past five years. In effect, from 1999 to mid-2004, privatisation operations increased markedly compared to the 1994-98 period, increasing from 63 transactions (711 million dinars) to 85 (1 501 million dinars). Numerous sectors were involved: telecommunications, business, tourism, banks, agriculture and some industries (construction materials, ceramics, glass, machinery and electrical).

In order to support local and overseas private investment, the government followed on with its efforts to develop industrial zones and improve the infrastructure of roads (developing and reinforcing nearly 1 350 km of listed roads, improving the Grand Tunis road and the road networks structuring the large towns, building the Tunis-Bizerte and Tunis-Medjez El Bab expressways), ports, and airports (modernising and increasing the capacity of the Tunis-Carthage and Djerba-Zarzis airports, beginning service at the new airport of Gabès-Matmata).

The 2000-04 period was equally marked by interest in the telecommunications and information technologies sector. The infrastructure in this sector was developed with a view to improving the competitivity of businesses and included standardising digital transmission, setting up a second satellite transmission (V-SAT) operator and improving network data transmission (ADSL, Frame relay, dedicated lines, etc.). A second mobile telephone operator was also approved. In addition, data transmission tariffs were reduced by 50 per cent, those of international calls by 25 to 40 per cent and subscription fees by 25 per cent for land lines and 25 to 42 per cent for mobile lines.

Political and Social Context

The 2004 presidential and legislative elections were a major political event. These were the first to follow the constitutional reform passed by referendum in May 2002, adopting a two-round ballot in the presidential election. In October 2004, Tunisians were called to choose their president from four candidates and their parliamentary representatives from around a thousand candidates, representing seven political parties and several independents. In the legislative elections, the ruling party won 152 of the 189 seats, or 80.4 per cent of the total. The opposition obtained 19.6 per cent of seats (against 18.7 per cent in 1999 and 11.7 per cent in 1994). In the presidential elections, President Ben Ali was accorded his fourth mandate, with 94.48 per cent of the vote.

The improving social context is particularly reflected in the reduction in poverty, which fell from 7.7 per cent of the population in 1984 to 4.2 per cent in 2000. The annual revenue per inhabitant increased, from 1 059 dinars in 1987 to 3 300 dinars in 2003; the government's goal is for this to reach 5 000 dinars by 2009. Social development is at the heart of the country's tenth plan (2002-06).

In the social sector, the first priority is to improve the education system and its links to the labour market. Employment is the greatest challenge to the Tunisian economy, with private sector job creation slowing down. The 2004 unemployment rate should be 13.9 per cent, down by almost two points from the 1999-2003 average. The general census, carried out in April 2004 revealed that unemployment, lasting approximately one year on average, affected 432 900 people between the ages of 18 and 59 years, out of a total population of around 10 million. Women are more vulnerable to unemployment than men (16.7 per cent versus 12.9 per cent). More alarming, unemployment is very high among young people and graduates. While young higher education graduates accounted for 7 per cent of job seekers in 2000, their numbers are constantly rising. To address this problem, the state is seeking to subsidise half of graduate salaries in the private sector in 2005 and to offer them 7 800 of the 12 000 posts that it intends to create in 2005. Strong growth, particularly in high-skill sectors, and continued improvement of labour market flexibility, would appear indispensable to significantly reducing the overall unemployment rate.

With the same perspective of improving quality of life, the government's housing policy supports the construction of decent housing, particularly for low-income groups. The campaign to eradicate slums was followed through: it accounted for only 0.8 per cent of residences in 2002, compared to 11.4 per cent in 1980. The proportion of households owning their residence significantly increased, reaching 79.2 per cent in 2003. The impact of this housing policy on improving quality of life has been more widespread, however, as it was reinforced by moves to improve collective facilities. The first results of the general and housing census, the *Recensement général de la population et de l'habitat* (RGPH) carried out in 2004, revealed: a sizeable increase in the proportion of those connected to a water distribution network (83.4 per cent in 2004 compared to 69.1 per cent in 1994); a huge increase in electrification (reaching 100 per cent in several towns and 98.9 per cent throughout the country in 2004, versus 85.9 per cent in 1994); and, a substantial increase in connection to the drainage network (77.4 per cent of households in 2004 versus 29.9 per cent in 1994). The RGPH also showed a strong increase in household possession of consumer goods in the last ten years, with increases in the proportion of households owning a car (21 per cent in 2004, over 15.7 per cent in 1994), television set (90.2 per cent versus 79 per cent), refrigerator (81.7 per cent compared to 55.4 per cent) or telephone (35.6 per cent over 15.7 per cent for a land line, given that in 2004, 46.1 per cent of households owned a mobile telephone). The government's social transfers policy underlies these results: between 1999 and 2003, transfers increased from 203.6 dinars to 258.4 dinars per household per month, bringing the social spending per inhabitant per annum from 507.2 to 640.6 dinars in nominal terms over the same period. Social security coverage – which accounts for almost 31 per cent of all social transfers – escalated, going from 82.7 per cent in 1999 to almost 87 per cent in 2004.

Considerable efforts have been made to develop the necessary human resources and facilities to extend this coverage and to adapt the system to free access. Since 2003, a reorganisation of the health system has been ongoing to increase its capacity to meet the needs of several segments of the population via services ranging from the preventative (vaccinations, testing, maternal and infant protection) to curative. To this end, the newest and most specialised techniques have been used.

Tunisia's efforts at improving health and sanitary coverage (in 2003, more than 80 per cent of the population were within 4 km of a hospital) have most notably resulted in the improvement of some tangible indicators. Thus, life expectancy at birth has increased, from 67.1 years in 1984 to nearly 73 years in 2003; infant mortality has fallen from 37.3 per thousand in 1990 to 22.1 per thousand in 2003; the total fertility rate reached nearly two in 2004; and medical coverage during pregnancy and birth of state-assisted segments neared 92 and 90, respectively. The increase in these last two indicators, combined that of household size (4.53 members versus 5.16 in 1994), give an indication of a profound change in women's behaviour and of their new status, both within the family and in Tunisian society.

The government is seeking to improve the quality and efficiency of basic education and to increase pre-school education coverage, to 25 per cent in 2006 from 17 per cent today. As part of this, the government has extended its priority schooling programme, begun in 2001. This entails strengthening teaching resources (increasing the hours spent consolidating each class's standard each week, fitting out libraries), logistics (multi-purpose/vocational rooms, revision rooms) and administration.

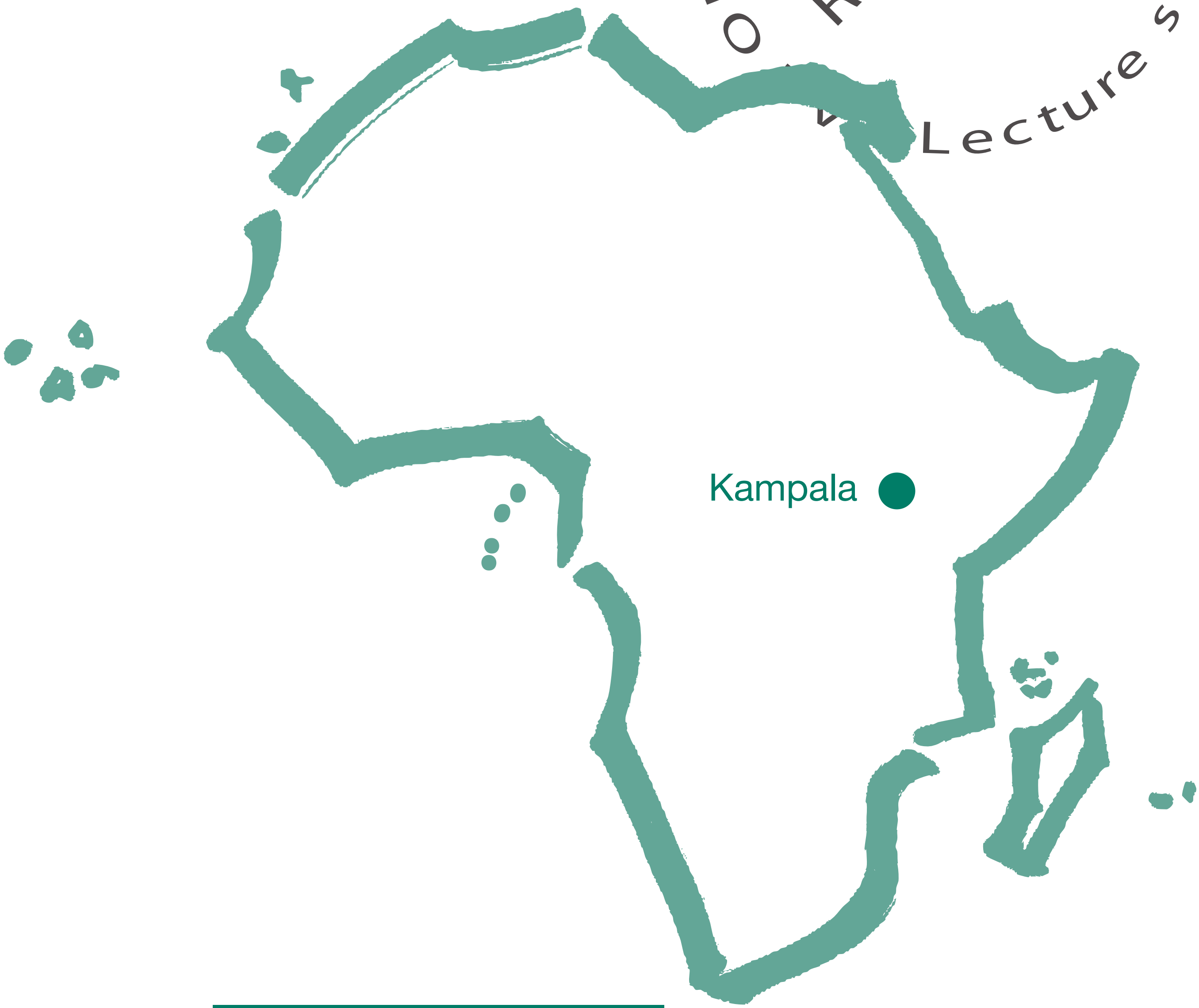
In respect to higher education, the government intensified its efforts to consolidate decentralisation and diversification of courses, as well as increasing the attractiveness of short courses and courses linked to information technology and new technologies.

After projects focusing on basic education (largely complete), and those now begun on higher education, the challenge to Tunisia's competitivity and modernisation lies in reforming secondary education. The public authorities have intensified their efforts to reinforce the education sector's resources, with almost one-quarter of the population in the education system. The education budget thus increased from 6.2 per cent of GDP in 2000 to 6.8 per cent in 2004.

In 2004, literacy in ten-year old children was nearly 80 per cent, compared to 54 per cent in 1984. The primary school enrolment rate was 98.1 per cent

(97.8 per cent in 1995) and enrolment rates for six-year olds were 99.1 per cent. The drop-out rate was 1.8 per cent. In secondary education, enrolment was nearly 77 per cent (girls representing 52.4 per cent) and completion was nearly 61 per cent (68 per cent in public education). Enrolment in higher education was 29.2 per cent (with girls accounting for 56.5 per cent of the total).

Uganda



key figures

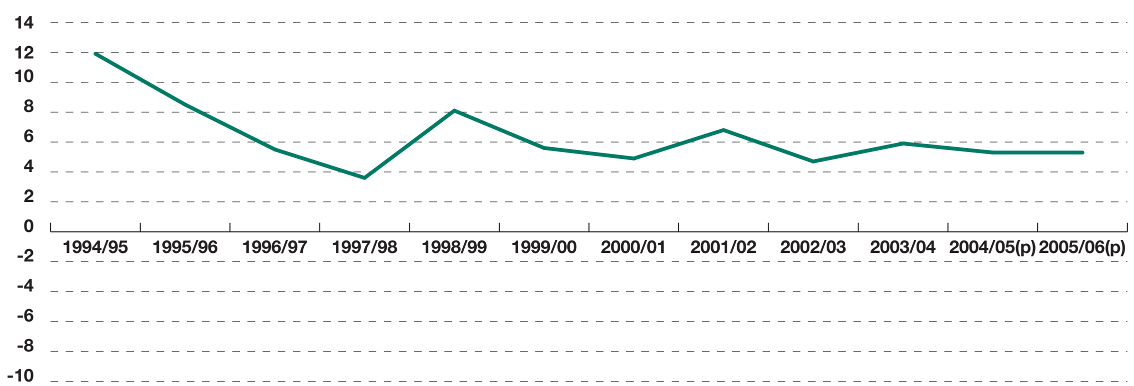
• Land area, thousands of km^2	241
• Population, thousands (2004)	26 699
• GDP per capita, $ (2003)	245
• Life expectancy (2000-2005)	46.2
• Illiteracy rate (2004)	29.3

SINCE YOWERI MUSEVENI and his National Resistance Movement (NRM) came to power in 1986, Uganda has recovered from the economic devastation wrought by Idi Amin. Annual output growth has averaged above 5 per cent, while fiscal consolidation and responsible monetary policy have brought inflation under control. This success has, however, relied heavily on foreign assistance. Uganda's management of multiparty elections scheduled for 2006 will in part determine whether donors continue their present high level of support. The security situation in northern and western Uganda is also a source of concern. Led by the stable and more prosperous southern areas, the percentage of the population living in poverty fell dramatically from 56 per cent in 1992 to 35 per cent in 2000, but health indicators remain very low, and poverty has actually edged up in the last few years, underlining the necessity of further structural reforms and reduction of corruption.

Prudent macroeconomic policies are paying off in steady economic growth and high levels of donor support.

Uganda's economic growth remains strong though the growth rate now appears to have stabilised at a lower rate than that seen in recent years. Real GDP growth was an estimated 5.9 per cent in 2004 and is

Figure 1 - **Real GDP Growth**



Source: IMF and domestic authorities' data; projections (p) based on authors' calculations.

projected to remain roughly steady at 5.3 per cent in 2005 and 2006. The Ugandan government's prudent pro-market economic policies are contributing to this strong growth performance. The government's budget, however, continues to rely heavily on external grants and is complicated by pressures for supplementary expenditure and high domestic interest costs. Maintaining fiscal stability may require greater efforts at raising domestic revenues. Prudence in monetary management has also contributed to controlling inflation. However, monetary management faces the challenge of increased sterilisation of aid inflows and how to manage the impact of sterilisation on the foreign exchange market and on export competitiveness. The external payments situation is stable, although exports remain concentrated on a few commodities.

The government is taking measures to increase the role of the private sector as an engine of growth. The development of Small and Medium Enterprises (SMEs) is seen as crucial in the growth process but these firms face credit constraints, which in turn derives from weaknesses in the institutional environment. Micro finance in the forms of lease financing and insurance premium financing represent the main avenues of financing for SMEs in Uganda.

Uganda's political climate is stable and decentralisation is taking hold in the country. However, security problems continue to undermine political stability and threaten democracy. Surveys indicate that corruption remains very high, but the government is taking measures to improve governance. Poverty and inequality in Uganda appear to be taking a turn for the worse.

Recent Economic Developments

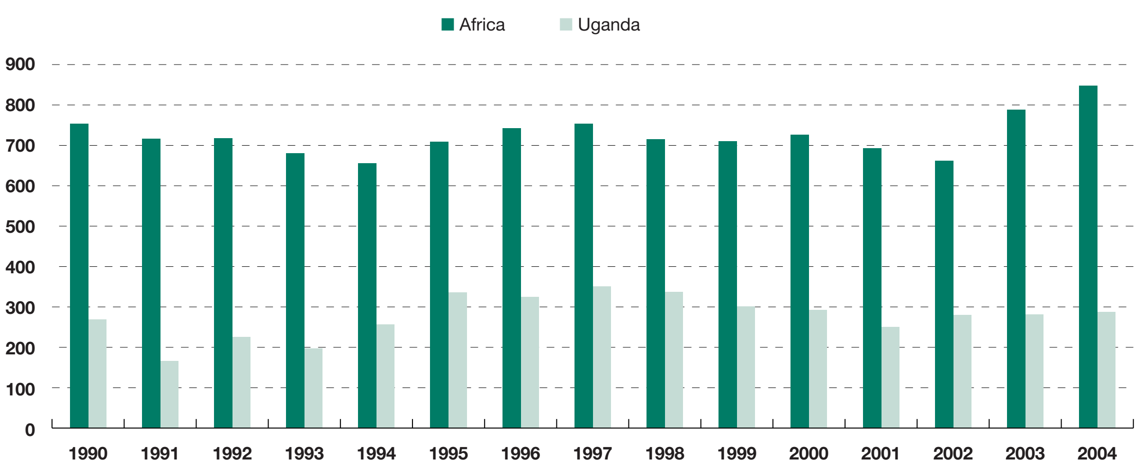
The Ugandan economy continues to grow rapidly, though the growth rate of GDP has fallen since the 1990s. Real GDP grew 5.2 per cent in 2003, and 5.9 per cent in 2004, with a forecast growth of 5.4 per cent in 2005. The solid performance in 2004 reflected growth in agriculture, construction and communications. The small forecast slowdown in 2005 reflects the expected effects of a current drought on agriculture.

Agriculture accounted for about 38 per cent of GDP in 2004 but is limited by persistent structural problems and needs better implementation of the current Plan for Modernisation of Agriculture and the Medium Term Competitive Strategy (MTCS) for the private sector, which includes the Strategic Export Programme (SEP). Agriculture is constrained by concentration on low-value crops and limited processing of raw produce. Limited access to support services such as crop and veterinary extension services and food-processing technology, inadequate infrastructure such as electricity and water, lack of market information, and proliferation of local taxes all inhibit the development of a vibrant agricultural sector with linkages to other sectors of the economy.

The industrial sector accounted for about 19.5 per cent of GDP in 2003. Industrial output rose by an estimated 4 per cent in 2004, the same rate as in the previous year, driven mostly by electricity generation, which rose by an estimated 6.3 per cent in the year. However, concern remained that the gain in industrial output in 2004 could turn out to be lower due to the shortage of power since September 2004. Electricity provision should improve as the government is progressing in the privatisation of power distribution, (possibly involving a partnership between the Commonwealth Development Corporation and Escom), scheduled for completion in 2005, and as a strategic investor is found for the two hydroelectric dams at Bujagali and Karuma Falls in 2005.

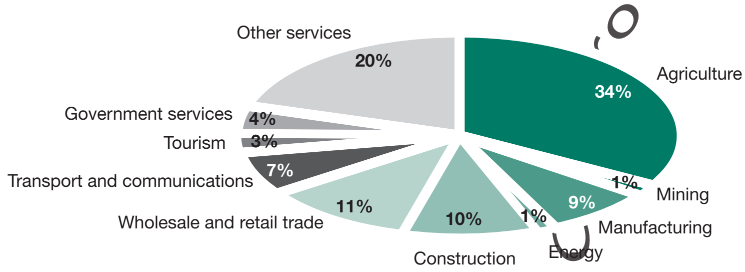
The service sector remains the largest contributor to GDP at 42 per cent in 2004. Continuing growth in the sector was spearheaded by the transport and communication sub-sector that gained from the large capital outlay in expanding and improving the Entebbe

Figure 2 - **GDP Per Capita in Uganda and in Africa** (current $)



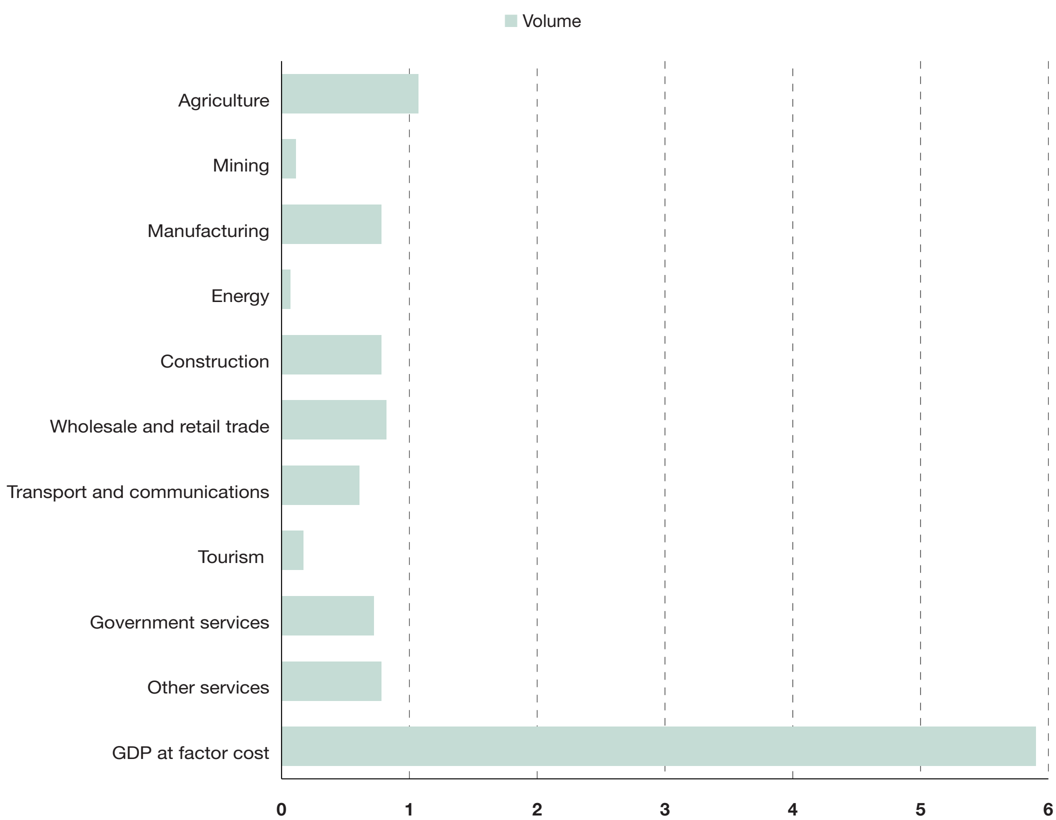
Source: IMF.

Figure 3 - **GDP by Sector in 2003/2004** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003/2004** (percentage)



Source: Authors' estimates based on IMF and domestic authorities' data.

International Airport and new investment in telecommunications following privatisation.

Recent growth has been underpinned by high, particularly private consumption. At the same time, the economy was estimated to achieve a peak in the share of gross capital formation in total output in 2004, due to high inflows of foreign savings. It is anticipated that capital formation will remain relatively high in 2005 and 2006.

Table 1 - **Demand Composition** (percentage of GDP)

	1996/97	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Gross capital formation	**18.9**	**18.5**	**19.7**	**20.6**	**21.7**	**22.7**	**24.6**
Public	6.4	5.8	5.3	4.7	5.2	5.2	5.3
Private	12.6	12.7	14.4	16.0	16.5	17.5	19.3
Consumption	**95.6**	**95.6**	**95.5**	**93.7**	**92.9**	**92.5**	**91.0**
Public	12.3	13.8	15.4	15.1	15.7	16.2	16.1
Private	83.3	81.8	80.1	78.5	77.2	76.3	74.8
External sector	**-14.5**	**-14.2**	**-15.2**	**-14.3**	**-14.6**	**-15.2**	**-15.5**
Exports	14.5	11.3	11.7	12.4	13.6	14.0	14.5
Imports	-29.0	-25.5	-26.9	-26.7	-28.2	-29.2	-30.0

Source: IMF data; projections (p) based on authors' calculations.

Macroeconomic Policies

Monetary and fiscal policies have three key objectives: *i)* stable inflation, interest rates and exchange rates; *ii)* increasing credit to the private sector; and *iii)* enhancing the international competitiveness of exports.

Fiscal Policy

Although the Ugandan government has maintained generally prudent fiscal policies, the overall management of the government's budget is subject to pressures for supplementary expenditure and higher domestic interest costs. In 2004, the overall fiscal deficit fell to 1.7 per cent of GDP from 4.3 per cent of GDP in the preceding year. It is expected that the fiscal deficit will widen in 2005 and 2006 as total revenues fall mainly on account of a decline in grants.

The government has made no policy adjustment to the recent oil price increase, which is largely viewed as temporary. The tax rates on oil products, which were established in July 1998, were adjusted in July 2003, and have remained the same since. Fiscal revenues from petroleum have also remained relatively stable since 2003. However, in July 2004 the government changed tax collection procedures on petroleum products. Taxes were to be collected at points of entry and not depots as had been the case before.

In 2004, domestic tax revenue showed only a marginal increase to 11.7 per cent of GDP from 11.3 per cent of GDP the year before, largely due to disappointing VAT receipts. Changes that were introduced in the collection of VAT on government contracts during the year proved more difficult to follow while there was also poor compliance by eligible payers. In addition, administrative inefficiencies contributed to the revenue shortfalls.

The government's commitment to increasing the share of the national budget funded through domestic resources has been made more difficult by the implementation of the East Africa Customs Union, slated to come into force in January 2005. The customs union is expected to reduce customs revenue by over 80 billion shillings in 2005 alone with further losses expected in the following two years. Consequently, the domestic tax effort is not expected to rise significantly and is estimated at 11.8 per cent of GDP in 2005.

Higher domestic interest rates continue to make it difficult for the government to rein in expenditures. In addition, a larger defence budget, caused by conflict with the Lords Resistance Army (LRA) in northern Uganda, has reduced the options for reducing current expenditures. In 2004, expenditures for poverty eradication under the Poverty Action Fund (PAF), hitherto ring-fenced, were curtailed. This raised concerns about donor support for the 2005 budget. In 2005, the government has cut non-priority non-PAF and non-wage expenditure to compensate for an increase in wages for 109 000 primary school teachers that was effective in April 2004 as well as for the clearance of domestic arrears accumulated in the past three years.

Monetary Policy

Table 2 - **Public Finances** [a] (percentage of GDP)

	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Total revenue and grants [b]	**15.7**	**18.7**	**19.0**	**19.1**	**22.2**	**20.7**	**20.0**
Tax revenue	10.6	10.4	11.4	11.3	11.7	11.8	11.9
Grants	4.5	7.6	7.0	7.0	9.6	8.0	7.2
Total expenditure and net lending [b]	**17.8**	**20.0**	**23.8**	**23.3**	**23.9**	**23.6**	**23.8**
Current expenditure	21.9	11.3	13.8	13.6	14.7	14.9	15.0
Excluding Interest	*20.9*	*10.1*	*12.3*	*12.2*	*12.7*	*13.1*	*13.1*
Wages and salaries	3.0	4.3	5.3	5.1	5.2	5.1	5.0
Interest	1.1	1.2	1.5	1.5	2.0	1.8	1.9
Capital expenditure	7.7	9.0	9.9	9.8	9.0	9.1	9.1
Primary balance	**-1.0**	**-0.1**	**-3.3**	**-2.8**	**0.2**	**-1.2**	**-2.0**
Overall balance	**-2.0**	**-1.3**	**-4.7**	**-4.3**	**-1.7**	**-2.9**	**-3.8**

a. Fiscal year begins 1 June.
b. Only major items are reported.
Source: Domestic authorities' data; projections (p) based on authors' calculations.

Uganda has made progress towards the 3.5 per cent annual inflation target of the government's Poverty Eradication Action Plan (PEAP). The progress made reflects success in controlling the monetary aggregates. Monetary policy continues, however, to face the challenge of managing excess liquidity arising from donor-funded expenditure inflows caused by the positive interest rate differential between Uganda and its neighbours.

Monetary aggregates slowed down in 2004 as the Bank of Uganda (BoU) widened its array of instruments for managing liquidity and developing the securities market. The BOU inaugurated the issuance of Treasury bonds with a 2-year, 3-year and 5-year maturity in early 2004. Sterilisation of excess liquidity appeared to be working as the growth in broad money supply (M3) slowed to 13.8 per cent in the year ending March 2004, from 25 per cent in the corresponding period in 2003. A major issue now confronting the monetary authorities is how to alleviate the impact of liquidity sterilisation on the exchange rate of the shilling and on export competitiveness. The challenge is heightened by the limited range of market intervention instruments at the BoU's disposal, especially since June 2004 when sterilisation using foreign exchange reserves was suspended.

Inflation has also been kept in check thanks to the limited pass-through of the recent world oil price increases to domestic pump prices. Two factors have been advanced as possible explanation for this: *i)* the strong appreciation of the shilling against the US dollar; and *ii)* increased local competition within the oil industry, lowering markups.

Since April 2004, however, upward pressure on prices has been observed due mainly to sharp rises in food crop prices resulting from the drought in some parts of the country. The annual underlying inflation, which declined from 5.2 per cent at end-December 2003 to 3.9 per cent at end-March 2004, rose marginally to 4 per cent at end-October 2004. Annualised headline inflation showed sharper swings, declining from 5.9 per cent at end-December 2003 to 1.7 per cent at end-March 2004, then increasing to 5.7 per cent at end-September 2004. The outlook on inflation is relative stability albeit at a higher level than the PEAP's target; the annual rate of inflation is projected at 5.3 per cent in 2005 and at 5.6 per cent in 2006.

Interest rates have declined as the BOU modified its liquidity sterilisation policy with the introduction of the long-term bonds. The annualised yield on the 91- day Treasury bill declined from 20.2 per cent at end-December 2003 to 7.9 per cent at end-October 2004. However, the lending rates of commercial banks have remained relatively flat, reflecting the lack of effective competition in the banking system.

The exchange rate of the Ugandan shilling has been allowed to move in tandem with economic fundamentals, with the BOU intervening to limit volatility. In a reversal of recent trends, the shilling appreciated by about 1.5 per cent against the US dollar between end-December 2003 and end-October 2004. The appreciation of the shilling reflected the weakness of the US dollar against other international currencies and on account of strong export receipts and inflows from NGOs.

External Position

Uganda's commitment to regional integration as a centerpiece of its development strategy bore fruit with the signing of the protocol establishing the East African Community (EAC)[1] Customs Union in March 2004. The protocol is to become effective in January 2005. Since signing the protocol, the EAC member countries have made progress in harmonising fiscal and monetary policies. They have also made progress in the harmonisation of policies in sectors such as education, agriculture, environment, defence, and have signed a protocol for the management of Lake Victoria. Uganda is also seeking to become a full member of the larger free trading bloc COMESA[2].

The country remains dependent on a few agricultural exports – coffee, fish, tea and cotton – and thus is vulnerable to sharp terms of trade shocks. Led by rapidly increasing fish exports, Uganda's exports have continued to perform fairly well and foreign reserves have withstood increasing oil prices. In 2004, the current account balance improved despite the widening of the trade deficit, due mainly to a substantial increase in public and private transfers. Transfers are expected to revert to normal levels in 2005 and, together with an increase in the trade deficit, may be expected to lead to a widening of the current account deficit.

The merchandise trade deficit widened in 2004, even though exports grew faster than imports, due to the fact that imports started from a higher base. The increase in exports in 2004 reflected improved export prices, especially for cotton, fish, tea, maize and flowers. The volume of exports of fish and fish products also gained from investment in processing facilities, reduction in informal exports and greater market access. The government of Uganda expects that fish will soon surpass coffee as Uganda's largest export. This may make Uganda less subject to terms of trade shocks, because fish may be less vulnerable than coffee to price fluctuations. Similarly, tea exports benefited from improved management of tea estates as well as strong government support services. Exports of flowers rose as a result of increases in farm size, construction of more green houses and declining freight charges. Export earnings from coffee, the main traditional commodity, rose in 2004 as a result of higher world coffee prices. For much of 2004, adverse weather conditions slowed coffee bean formation, harvesting and drying leading to a decline in export volumes. The adverse weather conditions have persisted into 2005 and affected coffee production making further reductions in export volumes for the year likely.

In 2004, the demand for imports increased in line with economic activity. In particular, imports of building materials continued to reflect the boom in construction, while imports of transport and telecommunication equipment, especially vehicles and mobile phones, also grew strongly.

In 2003, the external debt increased and the sustainability of the debt burden now represents a major point of discussion with the development partners. At the end of 2003, Uganda's total external debt was $4.05 billion. About 90 per cent of this debt was owed to multilateral institutions, 9 per cent to non-Paris Club bilateral creditors, and 1 per cent to Paris Club creditors.

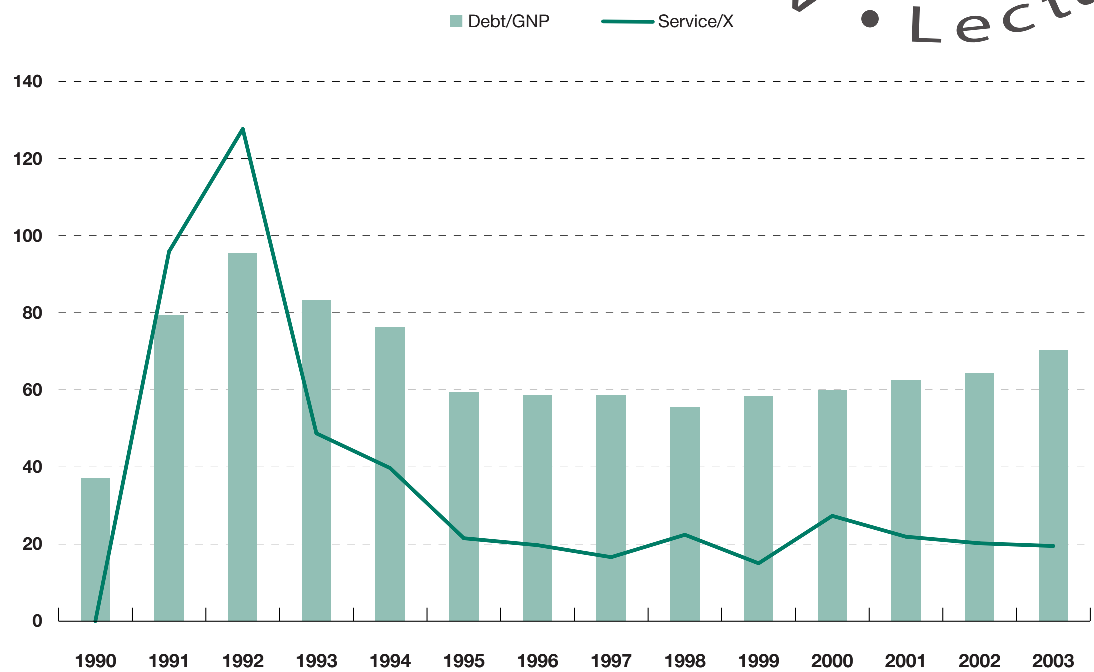
With loans accounting for about 40 per cent of donor inflows yearly, debt levels have risen substantially in spite of debt relief. Since Uganda completed the HIPC process, the country has borrowed about $1.5 billion from multilateral creditors. Although these loans have been secured on highly concessional terms,

1. The member countries of the East African Community are Kenya, Tanzania and Uganda.
2. The member countries of COMESA include Angola, Burundi, Comoros, DRC, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Zambia and Zimbabwe

Table 3 - **Current Account** (percentage of GDP)	1995/96	2000/01	2001/02	2002/03	2003/04	2004/05(p)	2005/06(p)
Trade balance	-11.4	-8.4	-9.6	-9.9	-9.7	-10.2	-10.6
Exports of goods (f.o.b.)	10.7	7.8	8.2	8.0	9.3	9.7	10.0
Imports of goods (f.o.b.)	-22.2	-16.2	-17.8	-17.9	-19.0	-19.9	-20.5
Services	-4.3	-3.5	-5.1	-4.1	-3.8		
Factor income	-0.8	-2.9	-2.2	-2.5	-2.5		
Current transfers	14.2	9.9	11.9	12.5	17.8		
Current account balance	**-2.3**	**-5.0**	**-4.9**	**-3.9**	**1.8**		

Source: Domestic authorities' data; projections (p) based on authors' calculations.

Figure 5 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

their impact on the debt stock, combined with lower export growth, has been to raise the ratio of the net present value (NPV) of the debt to exports. It is estimated that the current ratio stands at 350 per cent, which is more than double the HIPC debt sustainability threshold. The situation has been exacerbated by recent court rulings against the Ugandan government in favour of creditors including overseas companies and the Bank Arabe Espanol. The government's approach to improving the debt sustainability includes improving debt management as well as encouraging exports. In addition the government is committed to continue borrowing only on concessional terms.

Structural Issues

Uganda's current structural reforms are aimed at improving the investment climate and increasing productivity. Past reforms have removed institutional bottlenecks that hindered the development of the private sector, but investment has yet to respond to the desired extent. Under its 2005 programme to encourage investment, the government is considering amendments to ease barriers to investment. Also, the government is considering establishing a clear land use policy to allow flexible and full utilisation of idle land. The government is preparing an Investment and Free Zones Bill authorising Export Processing Zones.

The development of small- and medium-sized enterprises (SMEs) is crucial for employment and entrepreneurship: currently about 1.5 million people, some 90 per cent of the non-farming active population, are employed in micro and small enterprises.

Since 1987, the government has implemented a number of policy measures under the Economic Recovery Programme to create an enabling environment for private sector development. A Micro and Small-Scale Enterprise Policy Unit (MSEPU) has been established in the Ministry of Finance, Planning and Economic Development (MFPED). This unit is responsible for the co-ordination of all efforts to promote SMEs.

A major difficulty for SMEs in Uganda is financing, which is in large part attributable to weaknesses in the enabling environment, including lack of effective dispute resolution, inadequate bankruptcy laws, lack of an effective and modern business registry, absence of a credit reference agency, lack of a national identification system, and lack of an efficient legal system enabling prompt resolution of disputes.

Financial reforms since 2000 have improved commercial banks' soundness, but have done little to ease credit constraints for SMEs. Commercial banks in Uganda cite several reasons for their reluctance to lend to SMEs. These include poor book keeping; low levels of technical and management skills; lack of professionalism; shortage of collateral; lack of marketing skills; and limited knowledge of business opportunities. Yet, without credit, SMEs cannot resolve these problems, and without SME development, sustained growth is out of the question.

Microfinance is the main form of finance for SMEs in Uganda, and has developed since 1998 thanks to donor funding of about $40 million a year. At the end of 2003, approximately 1 500 microfinance institutions (MFIs) were serving over 935 000 small savers and close to 400 000 borrowers in the country. In that year, Parliament passed the Micro Deposit-Taking Institution Act which created the conditions for MFIs to become regulated, deposit-taking institutions. The government views the microfinance industry as a vehicle for extending financial services to a wider population with a target of reaching at least 1.3 million poor people by 2006. Microfinance stakeholders in Uganda have created several formal mechanisms for collaboration, including the Private Sector Donor Group (PSDG) for donors, the Microfinance Forum (MFF) and the Association of Microfinance Institutions of Uganda (AMFIU).

The main forms of micro-finance in Uganda include leasing facilities and insurance premium financing. The size of the leasing facility is typically between 2 million and 500 million shillings and may be taken in either US dollars or Ugandan shillings for a repayment period of between two and five years. The facility is available for any durable asset including plant, equipment, machinery, commercial vehicles and business cars. The ownership of the asset is maintained by the MFI throughout the lease period, with an option to purchase exercised by the lessee at end of the lease. The Insurance Premium Financing (IPF) facility is designed to enable SMEs to meet their insurance premiums promptly and spread the repayments over ten months.

The government hopes to complete the privatisation programme in the next one to two years. At the end of 2003, the government had divested about 117 enterprises leaving about 31 to be privatized. Most notably the government has identified investors for a joint concession contract for the Ugandan Railway Corporation and the Kenya Railway Corporation. This transaction is expected to be completed by mid-2005. Other notable enterprises slated for privatisation include the NIC and the public water and sewerage enterprise. The privatisation programme has presented an unexpected challenge to the government. While the programme was expected to reduce the financial burden from subsidies to loss-making enterprises, the growing number of regulatory bodies is proving very costly.

Political and Social Context

Uganda's political situation appears quite stable as the country moves towards general and presidential elections in 2006. The so-called "movement system" under which traditional political parties are banned, continues to dominate the political process. However, Ugandans are expressing a growing desire for greater pluralism in the political process, and many opposition party candidates were successful in the 2002 local elections. Movement to a multiparty system will be examined in the on-going constitutional review process.

On Transparency International's 2004 perceptions of corruption index, Uganda ranked 102nd out of 145 countries surveyed. A National Integrity Survey (2003) revealed some perceived improvement in the area of governance. Nonetheless, corruption was highlighted as a significant problem; it was particularly noted in the allocation of tenders and was responsible for driving up the costs of public sector investments and thereby impeding poverty reduction. The Ugandan government has reaffirmed its commitment to good governance as a cornerstone in its fight against poverty, and is pursuing a National Strategy to Fight Corruption and Build Ethics and Integrity in Public Offices (2004–2007). The programme's momentum was slowed, however, by a court ruling that the government's anti-corruption Leadership Code violates the Constitution. The government is considering ways to re-institute the Code, either through re-drafting the Code or a constitutional amendment.

Decentralisation has been policy since 1993, included in a vision of a local government system that is democratic, participatory and development-oriented. The policy is now part of the Constitution and has an elaborate legal framework under the 1997 Local Government Act. Implementation is co-ordinated by the Decentralisation Secretariat in the Ministry of Local Government.

The decentralisation policy has been implemented in a wide range of sectors starting with the democratisation of local councils. Democratic elections have been held for office from the lowest unit - Local Council 1 (LC1) to the highest organ at the district level – Local Council V (LCV). The policy has provided the framework for implementing a number of government initiatives including: the Poverty Eradication Action Plan (PEAP), the Plan for Modernisation of Agriculture (PMA), and the National Agricultural Advisory Service (NAADS). In a review of the decentralisation policy in November 2004, it was concluded that decentralisation was leading the transformation of the political landscape of the country, since local leaders are now chosen through free and fair elections and they can be held accountable.

Security problems continue to threaten democracy. The long-running conflict in the north of the country and the Karamoja (in the northeast) shows no signs of easing. While a concerted effort by the government to end the insurgency restored peace in some districts in 2003, even those districts where the insurgency subsided still suffered from spillover effects of internal displacement and rebel incursions in 2004. The government has developed a draft Internally Displaced Persons (IDP) Policy for consideration by parliament in 2005.

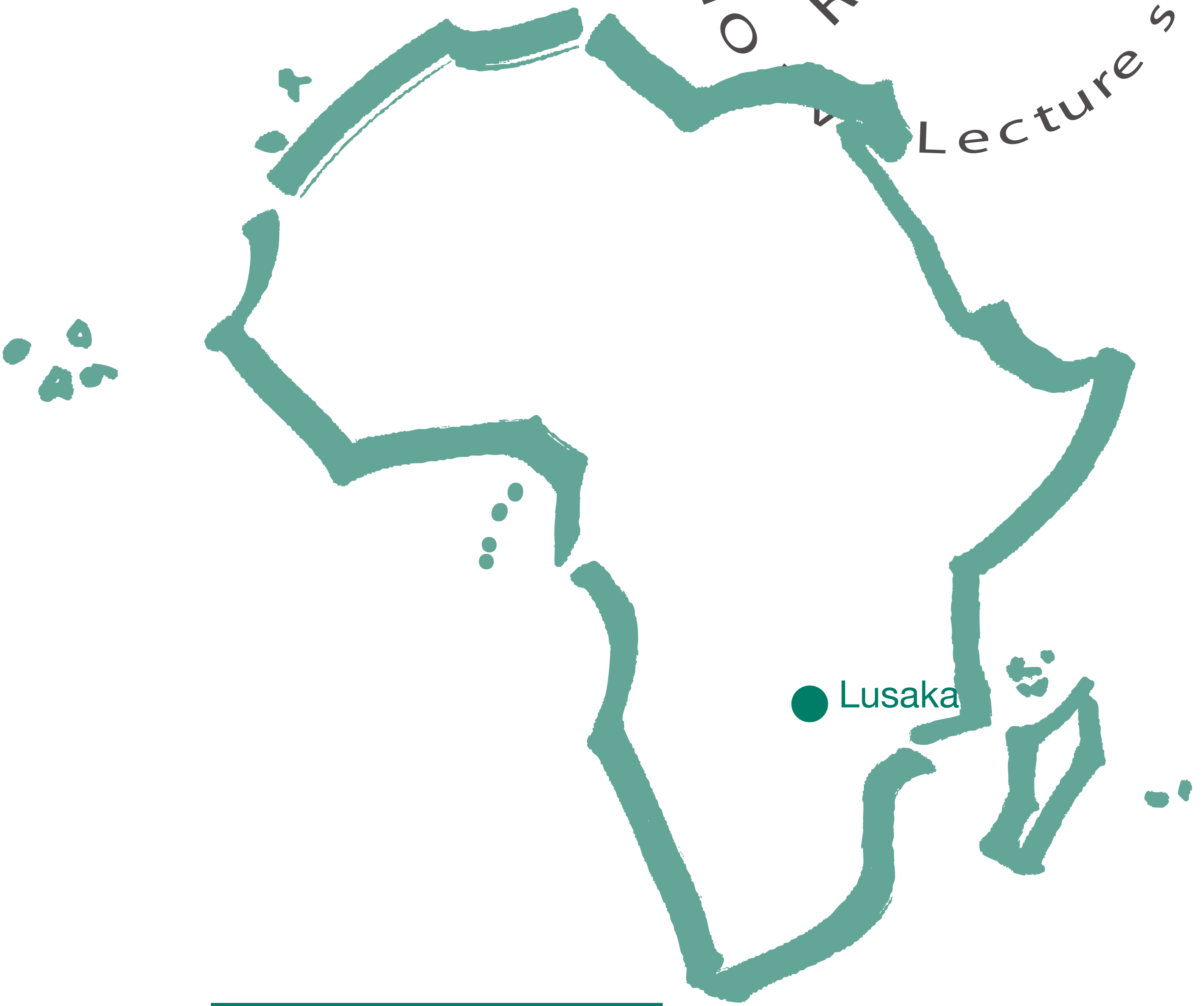
In spite of nearly a decade of implementation of the PEAP, the situation in Uganda appears to be taking a turn for the worse. According to the Ugandan National Household Survey 2003 (UNHS II), the percentage of people living in poverty is estimated at 38 per cent, corresponding to 8.9 million Ugandans. This marks a significant increase since 2000, when 34 per cent of the population (approximately 7.2 million Ugandans) were living in poverty. Notably, however, poverty remains well below the 44 per cent level of 1996/1997 when the PEAP began. The survey results indicate that between 1999/2000 and 2003, the absolute number of poor people increased more in rural areas than in urban areas even though the proportionate rise in poverty was actually higher in urban areas. The rise in poverty has particularly been marked in households where agriculture is the main occupation, with crop farmers worse off than those engaged in other agricultural activities.

Income inequality increased by 23 per cent between 1997 and 2003. These results underline the key challenges of increasing agricultural and non-farm productivity and incomes; providing a conducive environment for private investment growth; and increasing access by rural and urban poor households to productive assets and basic services as well as amenities.

The implementation of poverty reduction programmes has enhanced access to services by the population despite some shortcomings. Access to health care has improved following the abolition of cost-sharing. Under the Health Sector Strategic Plan (HSSP), some headway has been made in the provision of minimum health care delivery including new health centres and the upgrading of others. Yet, life expectancy was only 43.1 years in 2002, and child and maternal mortality are high. In 2002, the mortality rate for children under five was 141 per 100 000 births; in 2000, the most recent year for which adjusted WHO/Unicef data is available, the maternal mortality rate was 880 per 100 000 live births. Also, the quality of services remains a challenge, as the system continues to suffer under the weight of non-availability of drugs, absence of qualified health staff, lack of preventive primary health care, poor sanitation diseases and HIV/AIDS.

In the provision of basic education, the government has given priority to improvement of the quality of Universal Primary Education (UPE), with positive trends in selected quality indicators. Provision of instructional materials has resulted in the reduction of the pupil/book ratio from 6:1 in 2000 to 3:1 in 2003. School sanitation and hygiene has also improved. However, the delivery of high-quality primary education remains a challenge. Several factors including insufficient priority attached to education among parents, especially for girls, the lack of separate facilities for girls, absenteeism and tardiness by both teachers and pupils, and lack of school meals, contribute to the challenge.

Zambia



key figures

• Land area, thousands of km²	753
• Population, thousands (2004)	10 924
• GDP per capita, $ (2003)	401
• Life expectancy (2000-2005)	32.4
• Illiteracy rate (2004)	18.6

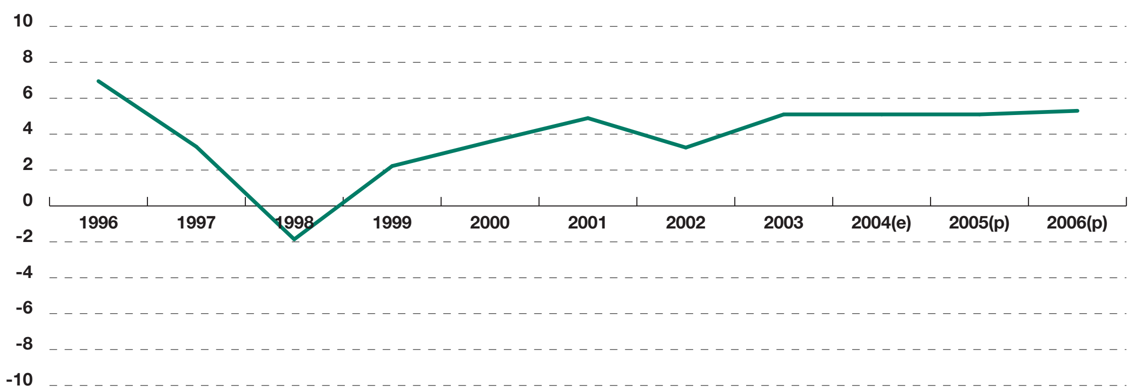
Against a backdrop of economic decline in the preceding two decades, Zambia achieved its fifth consecutive year of solid growth, with GDP growing at 5.1 per cent in 2004, significantly above the target of 3.5 per cent, as a result of strong copper output and exceptionally good agricultural performance. Strong GDP growth is expected to continue over 2005-06, at about 5 per cent, on account of increasing mining production and continuous efforts to raise agricultural productivity. However, the economy has not diversified and therefore remains highly vulnerable to climatic and terms-of-trade shocks. Growth has not significantly reduced poverty, which still affects more than 70 per cent of the population.

Under pressure from a rising domestic debt and the prospect of missing the HIPC completion point – initially expected to be reached at the end of 2003 – the government embarked on a major fiscal consolidation effort in 2004. The fiscal adjustment is part of a broader reform agenda. Comprehensive strategies are being discussed between the government and the donors to improve the accountability of public expenditure management, the soundness of the financial system and the development of the private sector.

The next two years will test the sustainability of government policies and 2004's macroeconomic stability.

The challenge will be to sustain the authorities' new policy stance. In particular, budget discipline will be important to resist spending pressures in the run-up to elections in 2006 and ensure attainment of the HIPC completion point, which is now expected in the first half of 2005, and that funds are dedicated to priority sectors, including the hiring of staff in education and health. In parallel, the reforms contemplated will need to be accelerated.

Figure 1 - **Real GDP Growth**



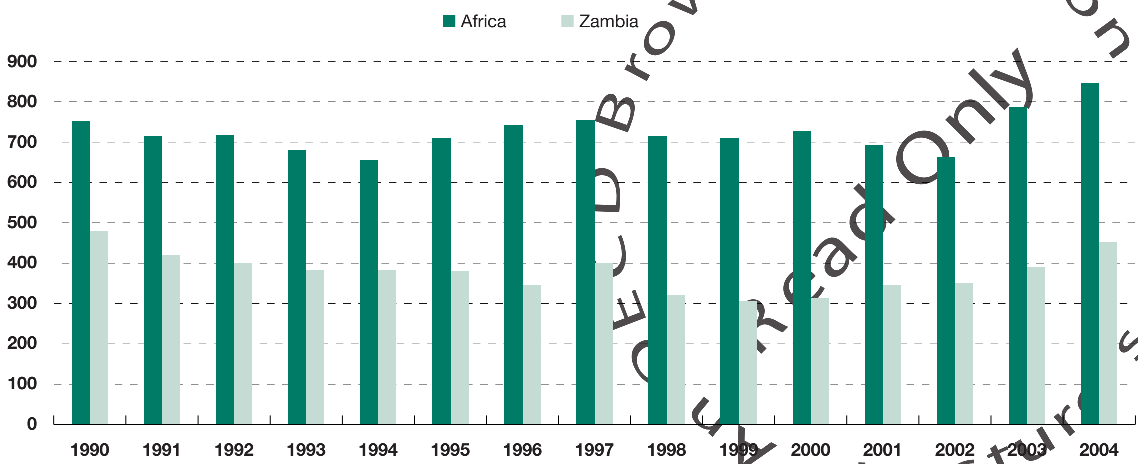
Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

Recent Economic Developments

Over the period 2000-03, growth averaged 4.2 per cent, driven by agriculture, mining activity, and a dynamic tourism sector. Strong agriculture and mining output, together with sizeable private investment, strengthened economic performance in 2004, bringing growth to an estimated 5.1 per cent.

After three years of scanty rains and drought forced the country to rely on external food aid, agriculture registered strong growth in 2002/03 and 2003/04.

Figure 2 - **GDP Per Capita in Zambia and in Africa** (current $)



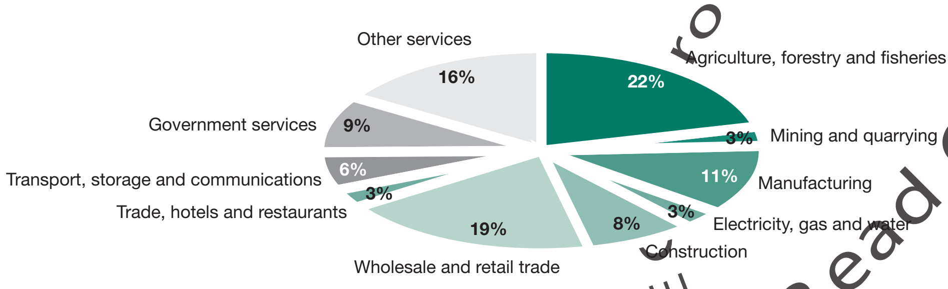
Source: IMF.

Good climatic conditions as well as timely delivery and distribution of inputs, resulted in a bumper harvest of maize, the main staple food, of 1.2 million tons compared to 0.6 million tons in 2001/02. Substantial production increases were also recorded in other crops, including wheat, sorghum, soya beans and groundnuts. With national needs of about 1 million tonnes, the overall food security of the population improved significantly, leaving 0.2 million tonnes of maize available for export. As demand from the neighbouring countries is strong, the Zambian authorities aim at making the country a leading regional maize exporter, mainly to import-dependent Zimbabwe, Angola and DRC. Export revenues are also benefiting from good cash crops, as the continued inflow of Zimbabwean farmers has translated into a boost in tobacco production, which grew by 86 per cent, reaching 37 million tons in 2003/04.

Despite substantial improvements in input delivery under the Fertiliser Support Programme (FSP), the agricultural performance of smallholders, who produce the bulk of agricultural output, remains vulnerable to rain patterns. Moreover, although 58 per cent of Zambia's total land is classified as having medium to high agricultural potential, only 14 per cent of it is currently under cultivation. The development of the sector is hampered by the lack of access to credit, infrastructural deficiencies, which translate into very high transport costs, and the absence of proper and consistent marketing channels.

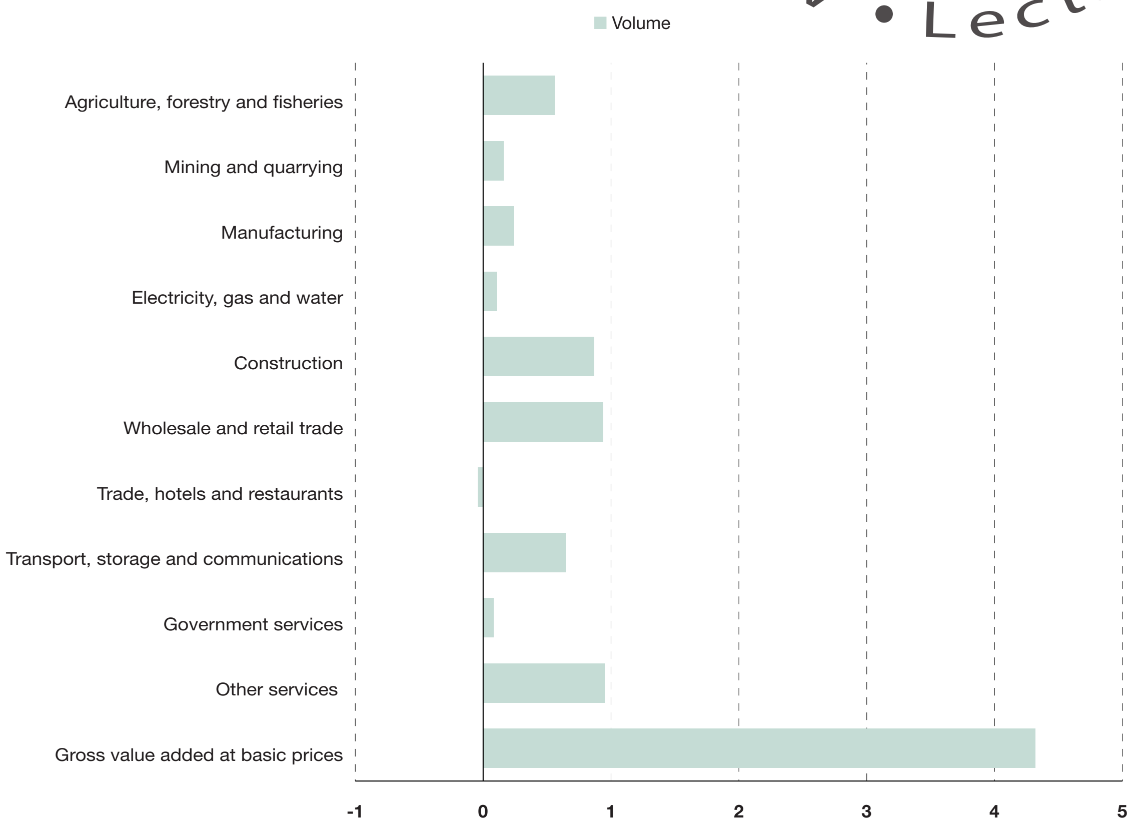
In an attempt to promote an efficient and sustainable agricultural sector, assuring food security and income generation, the government is following a two-pronged development policy. On the one hand, it prioritises the availability of inputs (irrigation, seeds, fertilisers) and extension services to small farmers; on the other, it supports the creation of outgrower schemes for commercial agriculture where smallholders grow crops "to order" for agribusiness in return for stable prices, inputs and training. This is outlined in the National Agricultural Policy for the period 2004-2015, which aims at increasing the agricultural contribution to GDP from the current level of 22 per cent to over 30 per cent by 2015. The policy also stresses the importance of developing linkages between smallholders and the agribusiness sector, through increased private sector participation in agricultural service delivery. In order to promote agricultural diversification and expand regional exports, major steps are also being taken in the promotion of livestock, through cattle restocking and animal diseases control, and fishery production – especially through the encouragement of aquaculture. Emphasis is also placed on the development of high-value products, such as spices (i.e. paprika), horticulture and floriculture. In the light of these efforts and of the good weather so

Figure 3 - **GDP by Sector in 2003** (percentage)



Source: Authors' estimates based on Central Statistical Office data.

Figure 4 - **Sectoral Contribution to GDP Growth in 2003** (percentage)



Source: Authors' estimates based on Central Statistical Office data.

far this year, Zambia is expected to have another sizeable harvest in the 2004/05 season.

Reflecting favourable copper prices and increased investment in the sector, mining production grew by 15.7 per cent in 2004, regaining its prominence in the Zambian economy. Copper prices averaged $1.19 per pound during the third quarter of 2004 compared to $0.77 per pound in same period of 2003. In 2002, the performance of the mining sector was adversely affected by the withdrawal of Anglo American from the Konkola Copper Mines (KCM), which produces two thirds of Zambia's copper, and the continued closure of Roan Antelope Mining Corporation of Zambia (RAMCOZ). In 2003 and in the first half of 2004, the government started a comprehensive economic restructuring programme aimed at promoting private sector-led mining development. Copper production jumped by 21 per cent in the first six months of 2004, as a result of improvements in technology at First Quantum Minerals' Bwana Mkubwa mine and the rehabilitation of the RAMCOZ mine (re-named Luanshya), which was bought in June 2003 by J&W Investments of Switzerland. The acquisition of 51 per cent of KCM by Vedanta Resources in August 2004, the rehabilitation of the second largest producer, the Mopani Copper Mines, and the coming on stream of the Kansanshi and Lumwana mines in 2005 and 2006 suggest overall good prospects for the sector. Total production is expected to increase from 403 000 tonnes in 2004 to 500 000 tonnes in 2006.

Buoyant agriculture and mining supported manufacturing performance. In particular, food, beverages and tobacco agribusinesses stood out as the leading and rapidly growing sub-sectors. Textiles and leather fared relatively well too, mainly owing to improved investment in cotton ginneries, which in turn led to increased exports of cotton yarns to South Africa.

Despite such positive achievement, manufacturing remains constrained by a series of bottlenecks, including the high cost of credit, the high cost base (mainly due to Zambia's landlocked status), administrative barriers and unfavourable duties on inputs compared to the rest of the region, which reduce competitiveness *vis-à-vis* neighbouring countries. More generally, entrepreneurs and business associations lament the lack of an overall vision and of a long-term development strategy, which also translates into inadequate/outdated regulatory framework, including protracted delays in the approval of the new Investment Act.

To improve the dialogue with the private sector and strengthen the business climate, the authorities have taken major steps in 2004, including the adoption of a private sector development plan focused on trade capacity building, regulation, infrastructure development, and SME financing. This initiative, together with spillover effects from continued investment in mining and agriculture are expected to benefit private sector activity in the medium term.

Restructuring of the mining sector and real estate developments, coupled with donor funded work in road rehabilitation, supported a booming construction sector, which grew by 5 per cent for the third year in a row. Donor-supported infrastructure projects and further investment in private commercial and residential housing estates are expected to ensure strong growth in the sector over 2005-06.

Tourism enjoyed strong growth in 2004 as a result of improved marketing and investment by the private sector, encouraged in turn by supportive measures, such as the recently established Tourism Development Credit Facility. Total arrivals at the Livingstone airport increased by 39 per cent to about 57 000 passengers. The number of tourists visiting the game parks increased by 9 per cent in 2004. However, the potential of the sector is not fully exploited owing to relatively poor

Table 1 - **Demand Composition** (percentage of GDP)

	1996	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Gross capital formation	**12.8**	**20.0**	**23.0**	**26.1**	**25.4**	**27.0**	**30.5**
Public	6.0	11.9	11.8	11.5	9.9	9.4	10.0
Private	6.8	8.2	11.1	14.7	15.5	17.6	20.5
Consumption	**93.4**	**95.6**	**90.4**	**84.8**	**82.4**	**86.7**	**86.8**
Public	18.3	12.8	13.0	14.6	12.9	13.0	13.7
Private	75.1	82.8	77.4	70.1	69.5	73.7	73.2
External sector	**-6.2**	**-15.7**	**-13.4**	**-10.9**	**-7.8**	**-13.8**	**-17.4**
Exports	34.0	29.0	28.6	31.0	34.3	30.3	27.4
Imports	-40.3	-44.6	42.0	41.9	-42.2	-44.1	-44.7

Source: IMF and Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

infrastructure in many national parks and cumbersome bureaucratic and regulatory requirements. In order to overcome these constraints, the authorities are designing a Tourism and Hospitality Bill, aiming at simplifying and rationalising the licensing framework in the sector, in line with international standards. Moreover, the donor community has launched a series of infrastructure development programmes in some tourist areas.

Against a background of increasing investment in the mining sector, private gross capital formation is expected to increase in 2005 and 2006. The associated increase in imports of capital goods will partially offset the growth of copper volume exports. Government consumption, which contracted sharply in 2004, following the restrictive stance of the Budget, is expected to increase moderately in 2005 and 2006, as poverty reduction spending increases and the 2006 presidential and legislative elections approach.

Macroeconomic Policies

Fiscal and Monetary Policy

Highly dependent on donors' assistance – which has financed some 30 per cent of the government budget – Zambia has anchored its macroeconomic policy on the Poverty Reduction Strategy Paper (PRSP) for 2002-2004 and the Transitional National Development Plan. However, frequent fiscal slippages experienced throughout 2003 – due mainly to overruns in public-sector wages and poor public expenditure management – undermined the authorities' ability to achieve the PRSP targets. Unsustainable government borrowing crowded out private-sector investment and reduced resources available for poverty reduction. As a result, the IMF suspended its budget support, and the country could not reach the completion point under the enhanced HIPC initiative, originally scheduled for 2003.

In 2004, the authorities engaged in a sharp fiscal adjustment in the framework of the new IMF Poverty Reduction Growth Facility approved in June 2004. The government implemented a painful and unpopular rationalisation of public employment, scaled back housing allowances, and froze public sector wages, reducing domestic borrowing from 5.1 per cent of GDP in 2003 to 2.1 per cent of GDP in 2004. The contraction in recurrent and interest expenditure more than offset the slight reduction in government revenue, mainly stemming from lower payments on profits and dividends by the financial sector. The overall budget deficit for 2004 is estimated at 3.9 per cent of GDP, compared to 6 per cent in 2003.

The fiscal measures freed up resources for poverty reduction spending, which doubled to 2.2 per cent of GDP in 2004, in line, for the first time, with the PRSP targets. In particular, the budget allocation for education met the target of 20.5 per cent of the total discretionary domestic budget. However, health spending was below its target, with poor reporting and limited absorption capacity at the district level. Formidable challenges still remain to improve transparency and the efficiency of budget execution, financial reporting, audits and procurements.

In order to improve efficiency, effectiveness and accountability in the management of public finance, the government, assisted by donors has designed a Public Expenditure Management and Financial Accountability (PEMFA) reform programme. The comprehensive programme, approved in June 2004, focuses on twelve areas of improvement, including budget preparation and execution, debt management, internal audit and control, and harmonisation of external aid. The programme for 2005 includes a pilot Integrated Financial Management Information System (IFMIS) in at least three ministries. PEMFA is part of a more ambitious Public Sector Reform Programme, launched at the end of 2003, which also encompasses civil service reform, and decentralisation of administration of resources to provinces and districts. However, progress in these two areas has been limited so far.

Based on the Medium Term Expenditure Framework (MTEF) for 2005-2007, the 2005 Budget calls for a further reduction in government domestic borrowing. To this end, the authorities would keep the wage bill below 8 per cent of GDP and curb non-priority expenditure. At the same time, they would increase priority expenditures on poverty reduction and track their implementation through quarterly budget execution reports, while settling domestic arrears, which in the past hindered the government's ability to execute investment projects. Sizeable outlays relating to the preparation of the 2006 legislative and presidential elections are also projected.

The moderate increase in current expenditures will be largely offset by a contraction in non-priority capital spending and higher revenue collection, stemming from the expiration of the temporary suspension of a 5 per cent import duty on petroleum products. The budget deficit is projected to fall to 1.8 per cent in 2005 and to increase slightly to 2.4 in 2006 as elections approach.

To finance the budget deficit, external programme assistance, mostly in the form of grants, is expected to increase substantially, limiting domestic borrowing to 1.5 per cent of GDP. To mobilise external support, the authorities will need to resist additional pressures to increase spending in this pre-election year, while improving public expenditure management, through PEMFA reform. The fiscal consolidation efforts, together with progress in major structural reforms, are expected to allow the country to reach completion point in the first half of 2005, thus triggering an external debt cancellation of $3.8 billion.

Inflation slowed in 2004, averaging 18.3 per cent, and well below the original target, despite the pass-through of higher world oil prices to consumers. The relative stability of the exchange rate of the kwacha and favourable food price developments helped contain inflation.

Table 2 - **Public Finances** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Total revenue and grants[a]	**26.8**	**24.8**	**26.1**	**25.1**	**22.7**	**24.5**	**24.7**
Tax revenue	19.0	18.6	17.4	17.5	16.8	17.3	17.4
Grants	6.1	5.7	8.3	7.0	5.2	6.6	6.7
Total expenditure and net lending[a]	**32.1**	**31.9**	**31.8**	**31.1**	**26.6**	**26.3**	**27.1**
Current expenditure	23.4	19.4	19.4	19.6	16.7	16.9	17.0
Excluding Interest	*18.6*	*16.9*	*15.4*	*15.7*	*13.8*	*14.1*	*14.9*
Wages and salaries	5.8	6.8	8.0	8.5	7.6	7.4	7.5
Interest	4.8	2.5	4.1	3.9	2.9	2.8	2.2
Capital expenditure	8.7	11.9	11.8	11.5	9.9	9.4	10.0
Primary balance	**-0.5**	**-4.5**	**-1.6**	**-2.1**	**-1.0**	**1.0**	**-0.2**
Overall balance	**-5.3**	**-7.0**	**-5.7**	**-6.0**	**-3.9**	**-1.8**	**-2.4**

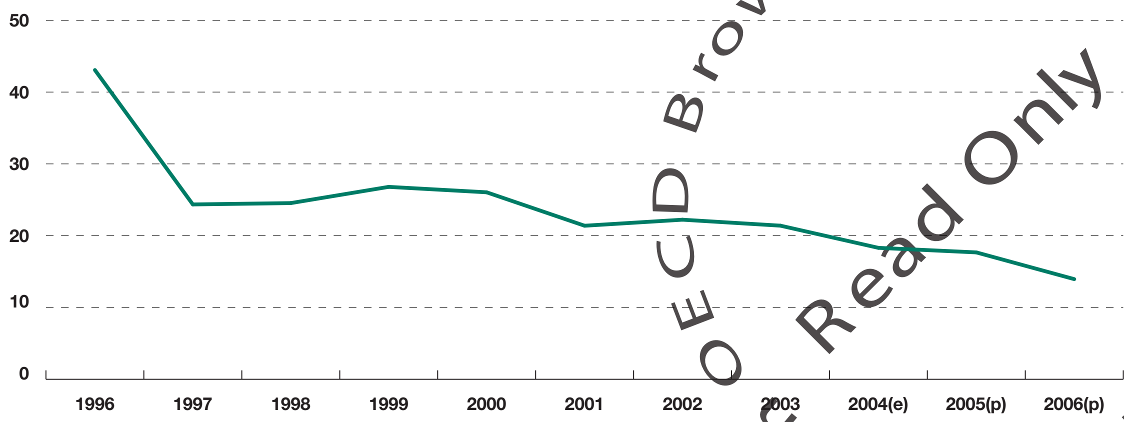
a. Only major items are reported.

Source: Ministry of Finance and Economic Development and IMF data; estimates (e) and projections (p) based on authors' calculations.

The central bank mopped up the excess liquidity that had arisen from the reduction in the statutory reserve requirement in October 2003. This last measure was aimed at freeing up resources for commercial lending; however, the sharp reduction in government borrowing coupled with persistent demand by the banking sector for government bonds put a downward pressure on treasury bill rates (from 32 per cent in November 2003 to 6 per cent in June 2004). The resulting negative real interest rates led the monetary authorities to soak up the excess liquidity, through open market operations. Interest rates on treasury bills went up to 17 per cent in November 2004, thus contributing to reducing inflation. Credit to the private sector increased by almost 40 per cent during the year through to September 2004, reflecting in part the incentive to switch to lower-cost domestic financing which prevailed during most of the year.

Inflation is expected to average 18 per cent in 2005 and to fall to 14 per cent in 2006, supported by lower pressure on food prices, and tighter monetary and fiscal policy. While the central bank will continue to eliminate remaining excess liquidity, fiscal restraint should allow

Figure 5 - **Annual Average Inflation Rate**



Source: IMF and Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

bank credit to expand in line with GDP growth.

Following the establishment of a broad-based inter-bank foreign exchange trading system in July 2003, the volatility of the kwacha/dollar exchange rate diminished. The kwacha has remained stable to the dollar and even appreciated slightly. The overall stability of the currency also reflected favourable copper prices and the depreciation of the dollar.

External Position

Pursuant to the Common Market for Eastern and Southern Africa (COMESA) Free Trade Area Agreement, since 2000 Zambia has eliminated the tariffs on originating products from the other FTA members, and granted trade preferences to the COMESA states not in the FTA. The country is currently investigating the effects of the proposed COMESA Customs Union and the adoption of a common external tariff (CET). A major stumbling block to this end is Zambia's simultaneous membership in the Southern African Development Community (SADC), which is the main trade partner. The situation is further complicated by the forthcoming negotiation of the Economic Partnership Agreement (EPA) with the EU, which has to be done on a regional basis.

Zambia benefits from a variety of preferential market access initiatives, including the Generalised System of Preference (GSP), the EU Everything But Arms initiative and the US African Growth and Opportunity Act (AGOA). However, serious supply-side constraints, including the limited capacity of Zambian producers to meet quality and safety standards, as well as the lack of a clear government export strategy, have significantly hampered the realisation of their full potential. According to US import data, the impact of AGOA on Zambian exports has been insignificant. This comes as no surprise since most Zambian exports already benefited from duty-free status under the US GSP and, even before being AGOA eligible, Zambia was unable fully to exploit its GSP quota. Zambian producers have not been able to access the US market for agricultural produce since the required pest risk assessment has not yet been completed.

Reinforcing the overstretched human and institutional resources within the Zambian trade administration is of foremost importance. The inclusion in 2004 of Zambia in the Integrated Framework for trade-related technical assistance to LDCs (IF) represents an important opportunity to address weaknesses in the formulation of the trade strategy and the support of export industries.

External developments in 2004 were extremely favourable. The external current account deficit narrowed, reflecting the tighter fiscal stance and a sharp improvement in the terms of trade (despite higher oil prices). Total export earnings are estimated to have increased by 50 per cent in 2004, mainly because of higher copper and cobalt exports. Copper receipts increased by 66 per cent in the period January to September 2004 compared with the same period in 2003. Mineral products account for around 69 per cent of total exports, followed by agricultural products, including tobacco, cotton, sugar, vegetables and cut flowers. In 2004, non-mineral exports have increased by 26 per cent. The EU is the largest export market (50 per cent of the total), followed by the SADC (25 per cent). Exports to the EU include copper, sugar, cut flowers and vegetables. Zambia's exports to its neighbouring countries mostly consist of sugar, cotton yarn, copper ores and copper cables, as well as the 2004 maize surplus.

Imports recorded an increase of 32 per cent in 2004, owing to the high demand for capital goods by the mining sector. Imports from South Africa represent more than 50 per cent of total imports, which include mining equipment, chemicals, processed foods and consumer products.

The trade balance is expected to deteriorate in 2005 and 2006, as a surge in imports of capital goods for new investment expansion and further refurbishment of the mining sector is expected to offset large increases in copper volumes. Moreover, while remaining at a high level, world prices of copper are projected to decrease with respect to their 2004 peak. Non-traditional exports are expected to perform well in 2005-06. Tobacco exports are projected to expand thanks to the British American Tobacco export agreement with Malawi for an estimated $2 million. Sugar exports are also expanding, because of an EU decision to increase the existing 20 000 export quota by 7 125 tonnes. On the negative side, horticulture exports might suffer from the financial irregularities that led Agriflora, the biggest vegetable and rose exporter, to collapse in 2004. Textile and clothing exports might also rise since the government has successfully negotiated with SADC partner countries an increase in its duty-free textile and clothing export quota to the region, from $3 million to $9 million.

The stock of external debt, which stood at $7.12 billion in 2002 declined to $6.45 billion at the end of 2003. The decline was mainly attributable to the implementation of the Paris Club Agreement of September 2002, through which bilateral creditors provided debt relief of up to 90 per cent for the consolidated period from January 2001 to 31 March 2003. The reduction in debt stock was also due to debt repayment amounting to $113.1 million in 2003.

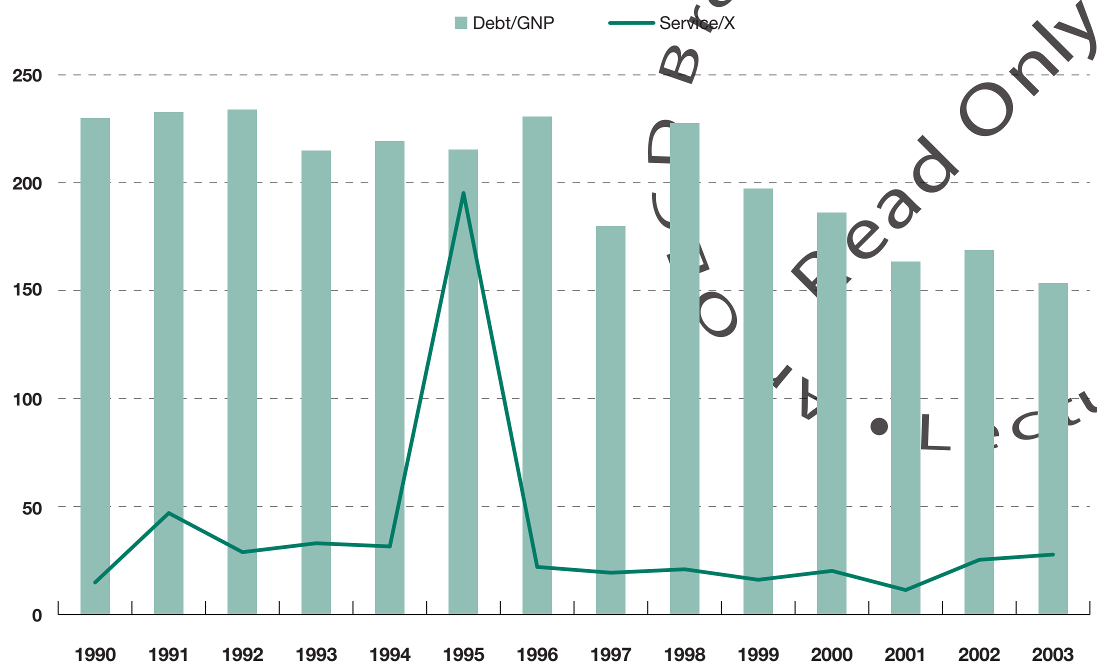
Table 3 - **Current Account** (percentage of GDP)

	1996	2001	2002	2003	2004(e)	2005(p)	2006(p)
Trade balance	-1.8	-10.1	-7.8	-6.3	-2.6	-8.0	-11.2
Exports of goods (f.o.b.)	30.4	24.3	24.8	25.9	30.0	26.2	23.5
Imports of goods (f.o.b.)	-32.3	-34.5	-32.6	-32.2	-32.6	-34.3	-34.7
Services	-7.6	-6.3	-6.6	-5.5			
Factor income	-6.4	-4.0	-4.2	-3.4			
Current transfers	-0.1	0.3	2.1	0.7			
Current account balance	**-16.0**	**-20.1**	**-16.6**	**-14.4**			

Source: Bank of Zambia and IMF data; estimates (e) and projections (p) based on authors' calculations.

The external debt increased to $6.8 billion in 2004, owing to positive flows on existing and new loans minus amortisation payments. A total of $129 million was spent on foreign debt service during the year. In the framework of the HIPC Initiative, total debt relief from bilateral and multilateral creditors amounted to $360 million for the year. As of end-2004, good progress was made towards meeting the triggers for the HIPC Initiative completion point, thereby accessing debt relief amounting to $3.8 billion. Zambia is expected to reach the completion point in the first half of 2005, provided that performance under the PRGF-supported programme, approved in June 2004 remains strong and implementation of poverty reduction strategy

Figure 6 - **Stock of Total External Debt** (percentage of GNP) **and Debt Service** (percentage of exports)



Source: World Bank.

is satisfactory.

Of the total external debt stock, the government accounted for 92 per cent, while private sector and parastatals accounted for the remaining share; 57 per cent was owed to multilateral institutions, while bilateral creditor debt represented 35 per cent.

Structural Issues

In 2004, the government moved forward with its structural reform agenda. This included HIPC Initiative completion point triggers: soliciting bids for privatisation of the Zambia National Commercial Bank (ZANACO), progress in the commercialisation of the Zambia Electricity Supply Corporation (ZESCO), and the restructuring of the non-bank financial institutions (NBFI), as part of a broader reform of the financial sector.

A bid for the sale of 49 per cent share of ZANACO, the largest commercial bank of Zambia, was launched by the Zambian Privatisation Agency (ZPA) in 2004, but Barclays' acquisition of ABSA (Amalgamated Banks of South Africa), the highest bidder, stalled the negotiations. Therefore, ZPA is currently negotiating with the second retained bidder, the African International Finance Holdings.

Progress has also been made in the commercialisation of ZESCO, through the appointment of a governing board, dominated by private sector representatives. A new article of association is expected to be approved shortly to ensure that there is no interference from the government, and a new energy bill under preparation is expected to be finalised by June 2005. The overall process of reform of the energy sector also included the establishment of the rural electrification authority (created in May 2004) and the rehabilitation of infrastructure.

The government is considering a commercialisation strategy for ZAMTEL, the national telecommunications company, which owns the monopoly of land lines, the international gateway and is the proprietor of mobile operator Cell-Z. A major issue concerning ZAMTEL, is its profitability. Almost 70 per cent of its revenue comes from control of the heavily congested international gateway connection, which is a more expensive way of providing international lines than satellites. So far, security reasons have led the government to stick to this option. However, the authorities are currently finalising a policy review and indications are that the report may recommend the reduction of the current high fees charged for an international gateway licence ($15 million) and open the system further.

In the mining sector, a major development was the sale of 51 per cent of the Konkola Copper Mines (KCM) to the Indian company Vedanta. Before this acquisition, the company had engaged in deep restructuring of operations, leading to a sharp fall in productions costs and expanded output, and leading to $60 million profits during the first six months of operations.

As part of a broader reform process aiming at exploiting synergies and reducing duplication, ZPA will be merged with four other agencies in charge of private sector development to create the Zambia Development Agency. These parastatals include the Zambia Investment Centre (ZIC), the Small Enterprise Development Agency (SEDA), Zambia Export Processing Zone Authority (ZEPZA) and the Export Board of Zambia (EZB). The legal structure of the new development centre still needs to be clarified; while ZPA's governing board is mainly composed of private sector representatives and directly reports to Parliament, the ZIC's board is mainly composed of government officials and reports to the Ministry of Commerce, Trade and Industry.

Since 2002, the government has embarked on an assessment of the financial sector, with technical assistance from the IFIs. The exercise culminated in the formulation of a Financial Sector Development Plan in June 2004, based on a wide consultation process. The Plan identified the reform of the legal and regulatory framework and the rationalisation of state-owned NBFIs as major steps towards strengthening the soundness of the sector. An amended Bank and Finance Services Act should reinforce the independence of the BoZ and its oversight role. The Plan also foresees the introduction by end-2005 of legislation for micro-finance institutions and a new Development Financing Act, replacing the Development Bank of Zambia Act. The latter would imply a renewed role for the NBFIs in providing development finance, in particular for the Development Bank of Zambia (DBZ).

The DBZ will be recapitalised, with private resources accounting for at least 75 per cent. As a first step, in September 2004, the Export-Import Bank of India increased the bank's capital by 35 per cent (injecting $1.4 million), and a new board of directors was being appointed. The International Fund for Agricultural Development (IFAD) has committed a $2.15 million contribution to strengthen the role of the National Savings and Credit Bank as a provider of rural finance. In the absence of an agreement over a viable business plan, no rescue strategy exists for the Zambia National Building Society, whose operations were reduced and are monitored by the BoZ.

Recent evaluations of the business climate in Zambia highlight a weak legal and regulatory framework, including protracted delays in the approval of crucial pieces of legislation, and poor contract enforcement. Poor transport infrastructure – only 45 per cent of the core road network is in good condition – also increases the cost of doing business in this land-locked country and limits market access. The difficult access and high cost of long-term finance, as well as stringent collateral requirements, are also often reported as major concerns by the business community. The private sector acknowledges, however, that poor managerial capabilities may constitute a bigger problem.

The private sector has also expressed concerns about the continuing lack of government vision, as reflected by recent conflicting signals on investment legislation. On the one hand, the President has formed a council of international advisors on investment and business climate (the Zambia International Business Advisory Council, ZIBAC); on the other, he is pushing for legislation reserving some sectors of the economy to indigenous business. The absence of a clear private-sector development policy has resulted in a piecemeal government approach to remove bottlenecks and promote growth. A long standing issue is the poor dialogue between the government and private sector. Field interviews suggest a lack of mutual understanding with respect to their relative roles and responsibilities in addressing such constraints. This also reflects the proliferation, polarisation and lack of cohesion among business associations.

In an effort to formulate a better strategy and improve the quality of the dialogue, representatives of the government, donors and the business community gathered in June 2004 for the Private Sector Development (PSD) Forum in Livingstone. The 280 Participants to the Livingstone Forum adopted a comprehensive action plan that is being translated into a concrete strategy and projects to be financed with donor support. This ambitious initiative, however, will require further efforts from donors to co-ordinate their projects, from the private sector to unify its views, and from the government to ensure a coherent approach.

Innovative formulas to provide regular financing to farmers: The Zambia Agribusiness Fund and the ZACA Warehouse Receipt Financing

In order to foster linkages between small-scale producers and commercial agribusiness, USAID has launched the **Zambia Agribusiness Technical Assistance Centre**. Addressed, in particular, to farmers who produce all-year-round crops, the centre provides technical assistance and supervises an investment fund that extends credit lines to farmers to buy irrigation equipment. Big commercial agribusinesses buy the crops (at a price net of the cost of the loan) and pay back the loan to the fund. Highly successful, this pre-financing export facility extends credits in US dollars, applying an interest rate averaging 8-10 per cent, compared to that in local currency of 35-40 per cent, and presents the advantage of ensuring the predictability of funds and repayment. The $1 million fund has benefited about 3 000 small-scale honey, horticultural and diary producers and it is already self-sustaining. The next step envisaged would be to convert credits into equities.

Another successful initiative implemented by USAID in 2002 in collaboration with the Zambian Agricultural Commodity Agency (ZACA) is a **warehouse receipts financing** programme. The farmers who benefit from a loan deliver the commodities to be stored in a bonded and insured warehouse; and the warehouse operator issues warehouse receipts. The receipts are warrants of the loan. Once the bank or the credit company has the warehouse receipts in its hands, it advances to the borrower a specified percentage of the value of the commodity stored. The amount it lends is primarily based on the acceptability and the ease of control of the collateral. Beneficiaries have accessed more than $700 000 in bank encashable warehouse receipts against their commodities stored in ZACA certified warehouses. To encourage and support local banks, the USAID-funded Development Credit Authority provides a 40 per cent guarantee to the loan. Problems may arise when local banks do not recognise receipts as documents of title. In this respect, ZACA has requested an amendment to the 1994 Agriculture Credits Act. In the medium term, the objective is to encourage the creation of farmers' associations to pool their demand for credit, minimise transaction costs and allow for mutual responsibility. The ultimate aim would be to complement the warehouse-receipt financing mechanism with hedging tools, developing a commodity stock market in Lusaka.

In parallel, USAID and other donors are financing local NGOs or technical assistance business associations, such as the Zambia Chamber of Small and Medium Business Associations in charge of providing business development services, to create market linkages between farmers, agribusiness and urban consumers, and ensure training in business skills.

In the key, mostly informal, SME sector, the bottlenecks mentioned above are exacerbated. Addressing their specific needs is complicated by the absence of a clear picture of the sector: no census of it has been undertaken, and the 1996 official SME definition, based on turnover or invested capital, is outdated by the high inflation environment. Observations suggest that SMEs are concentrated in trade and light manufacturing, including food, textile and clothing and timber. They find access to credit difficult and small businesses bemoan the lack of information about existing financing facilities. The absence of a central repository of information on customers credit conduct contributes to a bad repayment culture that in turn leads banks to require stringent collateral (equivalent to two to three times the value of the loan).

Donors and government agencies have embarked on a series of initiatives to improve access to finance for local companies. Since 2000, the World Bank, the European Investment Bank and Propaco have launched a third-party credit lines facility. In the World Bank sponsored programme, project-specific funds are disbursed by an Apex unit, managed by the BoZ, to selected commercial banks which are left with the responsibility of screening applications from firms and assuming part or all of the credit risk. These credits inject foreign-currency liquidity into the system at preferential rates. In turn, banks are able to offer foreign-currency-denominated loans at more attractive conditions (the interest rate differential ranging between 27 and 35 basis points). Although widely successful in expanding private-sector access to finance (disbursements in excess of $46 million have been made to more than 200 companies), this initiative has mainly benefited the larger and more formal companies. In fact, SMEs, which often lack financial statements and formal guarantees were generally unable to access these credit lines.

Other donors' initiatives more specifically targeted on SMEs have been encouraging (see box on previous page), revealing the existence of a pent-up demand for financial services emanating from small-sized businesses usually not serviced by commercial banks and outside of the micro-finance reach. Well-designed programmes show the possibility for local banks to move towards the lower end of the market when they are reassured by guarantees from donors and the development of credit-referencing bureaux. Furthermore, these initiatives are encouraging micro-finance institutions (MFIs) to extend credit lines to individual firms. The scale of these schemes remains, however, small owing to the limited capital base of MFIs, their dependence on donor financing and current regulations that place severe requirements for registering as micro-finance institutions.

Political and Social Context

The Zambian political situation has been relatively stable. In 1991, Frederick JT Chiluba's Movement for Multiparty Democracy came to power, promoting transition from the centrally planned economy that had been in place since independence in 1964. The newly liberalised political environment opened the way for comprehensive economic reforms; however, there were allegations of corruption and political interference in economic sectors. In 2001, Chiluba was succeeded by Levy Patrick Mwanawasa of the ruling party in a slim election result that was contested by the opposition.

President Mwanawasa has made the fight against corruption his centrepiece, receiving strong support from the donor community. The former administration was made accountable for theft of public resources in a trial which started in the last quarter of 2003. However, the trial lost momentum in 2004, owing in part to the lack of co-ordination between the courts, the Anti-Corruption Commission, and a special Task Force created by the President to investigate cases of corruption. This situation has created discontent; some civil society organisations have complained that corruption is fought on a selective basis – little is done to combat the widespread petty corruption of junior officials – and that the current legislation does not allow access to public documents for press investigations.

A strong independent press and civil society organisations are closely following the government's constitutional review process aimed at rebalancing powers away from the presidency, introducing an absolute majority clause for presidential elections and increasing freedom of information. Recent statements from the President suggest, however, that the new constitution will not be adopted until after the 2006 elections, causing further division amongst the civil society, opposition politicians and the government.

The PRSP for the years 2002 to 2004 aimed at reducing the poverty rate to 65 per cent of the population in 2004 (its 1996 level) from 78 per cent in 1998 and at achieving strong sustained economic growth. During the period of January 2002-June 2003, progress was disappointing, according to the PRSP intermediate assessment, owing to the government's failure to disburse all the resources allocated for poverty reduction (only 25 and 50 per cent of the amounts allocated in 2002 and 2003 were actually disbursed), and poor co-ordination between district development plans and the national PRSP. However, the draft progress report covering the period June 2003-January 2005 shows improvements. Allocations to poverty related programmes increased and reached the target of 2.2 per cent of GDP in the 2004 fiscal year; but implementation problems remain in some areas, notably in the health sector which suffers from limited absorptive capacity at district level and an increasing brain drain – there are only 700 doctors left in the country, and more than 2 000 nurses have left for the United Kingdom over recent years. The 2003 review of the 2001-06 National Health Strategic Plan highlighted the need to improve the monitoring system, raise public health expenditures from the current 10 per cent of discretionary budget to 15 per cent, and create a task force of human resources to counteract the retention problems in rural areas.

Malaria and respiratory infections remain the main causes of death, and there has been no improvement over the past two years according to health indicators. Conversely, the under-five mortality rate has decreased (to 168 per 1000 compared to 194 in 1996) thanks to a rise in the full immunisation coverage for children under one year of age. However, despite an increase in supervised deliveries by almost 50 per cent between 1999 and 2002, the maternal mortality rate was still high, at 729 per 100 000 in 2002.

According to the 2002 Zambia Demographic Health Survey, 16 per cent of the population aged 15-49 is HIV positive. The infection rate is substantially higher among women (18 per cent) than men (13 per cent). Morbidity and mortality due to HIV/AIDS have continued to escalate, overwhelming the health care service – it is estimated that about 70 per cent of medical hospitalisation admissions are related to them.

In September 2004, Zambia declared HIV/AIDS a national emergency. Through a number of initiatives, including Global Fund-supported programmes, and the Zambia National Response to AIDS, the government has scaled up the health sector's response, increasing the number of Voluntary Counseling and Testing (VCT) programmes, improving management of opportunistic infections, and strengthening the national laboratory capacity. Ahead of the government's target, 13 500 people were already receiving anti-retroviral drugs (ARVs) at the end of 2004, paying a cost-sharing fee of 40 000 kwacha ($8), and the authorities announced their intention to extend provision to 100 000 people – half of the 200 000 currently in need of treatment – by 2005. Concerns have been raised about the equity of the treatment as the majority of people that benefit are in Lusaka. This is attributable to the general lack of information on the availability of services in the rest of the country. Furthermore, a major barrier to the wider access of ARVs is the cost-sharing policy. Exemptions exist in principle for the most vulnerable, but these are rarely applied.

The draft HIV/AIDS policy currently under formulation is considering offering free treatment for those accessing treatment in low-cost care services. In order to scale up the HIV/AIDS treatment programme, the policy will also focus on promoting routine health testing and counselling in ante-neonatal and sexually transmitted disease (STD) clinics. Substantial efforts will be made to train health professionals in ARVs delivery.

In the education sector, the abolition of fees for government primary schools in 2002 has resulted in an increase in enrolment in primary education, from 70.5 per cent in 2001 to 76.5 per cent in 2003. Primary completion rates have also improved from 65.3 per cent in 2001 to 72.9 in 2003. Secondary education, however, suffered major problems in 2003. Budgetary expenditure overruns led to the suspension of the PRGF, and the Ministry of Education's payroll was frozen, leaving about 10 000 new teachers unemployed, and leading to a steep increase in the pupil/teacher ratio. This in turn has led many teachers to arbitrarily set ceilings for enrolment along with requests for monetary or non-monetary contributions (such as school uniforms).

The overall picture of the education sector has improved over the past year. Domestic allocations to the sector have increased – the 2004 benchmark for the HIPC completion point, set at 20.5 per cent of domestic discretionary budget, was met. The 2005 budget foresees substantial hiring of teachers, while outstanding severance benefits are expected to be paid to 7 000 teachers no longer in service, allowing a similar number to be hired.

Part Three

Statistical Annex

List of Tables

Methodology

Tables 1 to 6

Where indicated, the figures are reported on a fiscal-year basis. Figures for Egypt, Ethiopia, Kenya, Mauritius, Tanzania, and Uganda are from July to June in the reference year. For South Africa and Botswana, fiscal year 2003 is from April 2003 to March 2004.

Table 7. Exports, 2002

The table is based on exports disaggregated at 4 digit level (following the SITC3).

Table 8. Diversification and Competitiveness

The diversification indicator measures the extent to which exports are diversified. It is constructed as the inverse of a Herfindahl index, using disaggregated exports at 4 digits (following the SITC3). A higher index indicates more export diversification.

The competitiveness indicator has two aspects: the sectoral effect and the global competitivity effect. In order to compute both competitiveness indicators, we decompose the growth of exports into three components: the growth rate of total international trade over the reference period (1998-2002) (not reported); the contribution to a country's export growth of the dynamics of the sectoral markets where the country sells its products, assuming that its sectoral market shares are constant (a weighted average of the differences between the sectoral export growth rates – measured at the world level – and total international trade growth, the weights being the shares of the corresponding products in the country's total exports); the competitiveness effect, or the balance (export growth minus world growth and sector effect), measuring the contribution of changes in sectoral market shares to a country's export growth.

Table 11. Aid Flows

DAC countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States.

Table 13. Demographic Indicators

Infant mortality rate: under one-year-old child deaths per live birth per year.

Total fertility rate: average number of children per woman.

Mortality under age 5: probability that a newborn infant would die before the age of 5.

Table 14. Poverty and Income Distribution Indicators

National poverty line: absolute poverty line corresponding to the value of consumption necessary to satisfy minimum subsistence needs.

International poverty line: absolute poverty line corresponding to a level of income or consumption of $1 or $2 a day.

Gini index: index measuring the intensity of inequality in income or consumption expenditure distribution. Perfect equality leads to a Gini index of zero and maximum inequality to a Gini index of 100.

Share of consumption: share of total

consumption for a decile of the population ranked by level of consumption.

Table 15. Basic Health Indicators

Life expectancy at birth: average number of years a newborn infant would live under the hypothesis that, during its life, the conditions of mortality remain the same as observed at its birth.

Life expectancy at birth with AIDS: estimated average number of years a newborn infant would live under the hypothesis that, during its life, the conditions of mortality remain the same as observed at its birth in particular the characteristics of AIDS epidemic.

Life expectancy at birth without AIDS: estimated number of years a newborn infant would live under the hypothesis of absence of AIDS during its life.

Undernourishment prevalence: proportion of the population that is suffering insufficient food intake to meet dietary energy requirements continuously.

Food availability: available nutritious food for human consumption expressed in kilo-calories per person per day. Note that the recommended daily caloric intake for an active healthy life is 2 100 calories.

Public share of total health expenditure: share calculated by defining public health expenditure as current and capital outlays of government, compulsory social security schemes, extra-budgetary funds dedicated to health services delivery or financing and grants and loans provided by international agencies, other national authorities and commercial banks.

Private share of total health expenditure: share calculated by defining private expenditure as private insurance schemes and prepaid medical care plans, services delivered or financed by enterprises, outlays by non-governmental organisations and non-profit institutions serving mainly households, out-of-pocket payments, and other privately funded schemes not elsewhere classified, including investment outlays.

Table 16. Sanitary Conditions

Healthy life expectancy at birth: average equivalent number of years in full health a newborn infant would live under the hypothesis that, during its life, the conditions of mortality and ill-health remain the same as observed at its birth.

Sanitation coverage: percentage of population with access to improved sanitation technologies (connection to a public sewer, connection to septic system, pour-flush latrine, simple pit latrine or ventilated improved pit latrine).

Water supply coverage: percentage of population with access to improved water supply (household connection, public standpipe, borehole, protected dug well and protected spring or rainwater collection).

Table 17. Major Diseases

People living with HIV/AIDS: estimated number of people with HIV whether or not they have developed symptoms of AIDS.

HIV/AIDS adult prevalence: estimated percentage of the adult population (15-49) living with HIV/AIDS.

Malaria notified cases: cases of malaria reported from the different local case detection and reporting systems. These figures should be considered with caution because of the diversity of sources and probable underestimation.

Measles incidence: number of new cases of measles reported during the reference year.

MCV: Measles Containing Vaccine.

DTP3: Third dose of Diphtheria and Tetanus toxoids and Pertussis vaccine.

Table 19. School Enrolment

Gross enrolment ratio: population enrolled in a specific level of education, regardless of age, expressed as a percentage of the official school-age pupils enrolled in that level.

Net enrolment ratio: official school age population enrolled in a specific level of education expressed as a percentage of the total population enrolled in that level.

Table 20. Corruption Perception Index, 1999-2004

The Corruption Perception Index (CPI) is a composite indicator based on surveys of business people and assessments of country analysts. 17 sources were included in the 2004 CPI, originating from 13 independent institutions: Freedom House, The Economist Intelligence Unit, Pricewaterhouse Coopers, The Institute for Management Development, the Political and Economic Risk Consultancy, the World Bank, the World Economic Forum, Columbia University, Gallup International, Information International, Multilateral Development Bank, the Business Environment and Enterprise Performance Survey and the World Markets Research Centre.

A background paper presenting the methodology and validity of the CPI is available on the Transparency International web site: http://www.transparency.org/cpi/2003/dnld/framework.pdf

Table 21 to 23. Political Indicators

The political indicators were built on information taken from the weekly newspaper Marchés Tropicaux et Méditerranéens according to a methodology first proposed by Dessus, Lafay and Morrisson[1]. The qualitative information derived from the newspaper were either computed as 0-1 variables with 0 being the non-occurrence of the event and 1 its occurrence or as 4-value indicators (with 0: non-occurrence, 1: occurrence but weak intensity, 2: medium intensity and 3: strong intensity). From these indicators, three main political indexes were constructed: an index of conflicts, a measure of the softening of the political regime and one of its hardening.

Table 21. Political Troubles

- Strikes

0 = non-occurrence,

1 = 1 strike or number of strikers lower than 1 000 (inclusive),

2 = 2 strikes or number of strikers between 1 000 and 5 000 (inclusive),

3 = 3 strikes or number of strikers higher than 5 000.

1. Dessus, S., D. Lafay and C. Morrisson (1994), "A Politico-economic Model for Stabilisation in Africa", *Journal of African Economies*.

- Unrest and violence (number of dead and injured)

Dead
0 = none,
1 = between 1 and 10 (non inclusive),
2 = between 10 and 100 (non inclusive),
3 = higher than 100.

Injured
0 = none,
1 = between 1 and 50 (non inclusive) or if the number of dead is between 1 and 10,
2 = between 50 and 500 (non inclusive) or if the number of dead is between 10 and 100,
3 = higher than 500 or if the number of dead exceeds 100.

- Demonstrations

0 = non-occurrence,
1 = 1 demonstration or number of strikers lower than 5 000 (non inclusive),
2 = 2 demonstrations or number of strikers between 5 000 and 10 000 (non inclusive),
3 = 3 demonstrations or number of strikers higher than 10 000.

- Coup d'état and attempted coups d'état

Table 22. Softening of the Political Regime

- Lifting of state of emergency

- Releases of political prisoners

- Measures in favour of human rights

- Improvement of political governance (fight against corruption…)

- Relinquishment of political persecution, rehabilitation, return from exile

- Political opening (measures in favour of democracy)

1 = Discussion with the opposition,

Weights in "Political troubles"

	Weights
Strike	0.286
Dead	0.950
Injured	0.958
Demonstration	0.543
Coups d'état and attempts	0.059

Weights in "Softening of the political regime"

	Weights
Lifting of state of emergency	0.282
Release of political prisoners	0.709
Measures in favour of human rights	0.373
Improvement of political governance	0.089
Relinquishment of political persecution	0.502
Political opening	0.373
Lifting of bans on strikes	0.323
Lifting of bans on public debates	0.522

Weights in "hardening of the political regime"

	Weights
State of emergency	0.631
Violence perpetuated by the police: Dead	0.261
Injured	0.423
Arrests	0.402
Additional resources for the police	0.603
Toughening of the political environment	0.253
Prosecutions, executions	0.583
Bans on strikes	0.383
Bans on demonstrations	0.292
Closing of schools	0.092

Table 1 - Basic Indicators, 2003

	Population (thousands)	Land Area (thousands of km²)	Population Density (pop / km²)	Gross Domestic Product (Current price, $ million)	GDP per Capita (Current price, $)	Annual Real GDP Growth (average over 1996-2003)
Algeria	**31 800**	**2 382**	**13**	**66 530**	**2 092**	**3.6**
Angola	**13 625**	**1 247**	**11**	**13 825**	**1 015**	**6.6**
Benin	**6 736**	**113**	**60**	**3 557**	**528**	**4.8**
Botswana**	**1 785**	**582**	**3**	**7 925**	**4 440**	**5.7**
Burkina Faso	**13 002**	**274**	**47**	**4 264**	**328**	**5.5**
Burundi	6 825	28	245	595	87	0.0
Cameroon	**16 018**	**475**	**34**	**13 806**	**862**	**4.7**
Cape Verde	463	4	115	831	1 794	7.0
Central Afr. Rep.	3 865	623	6	1 197	310	0.7
Chad	**8 598**	**1 284**	**7**	**2 637**	**307**	**5.6**
Comoros	768	2	344	308	401	1.9
Congo	**3 724**	**342**	**11**	**3 564**	**957**	**2.8**
Congo Dem. Rep.	**52 771**	**2 345**	**23**	**5 681**	**108**	**-1.5**
Côte d'Ivoire	**16 631**	**322**	**52**	**14 045**	**845**	**1.7**
Djibouti	703	23	30	625	889	0.9
Egypt*	**71 931**	**1 001**	**72**	**80 189**	**1 115**	**4.7**
Equatorial Guinea	494	28	18	2 977	6 026	32.2
Eritrea	4 141	118	35	751	181	2.7
Ethiopia*	**70 678**	**1 104**	**64**	**6 637**	**94**	**3.8**
Gabon	**1 329**	**268**	**5**	**6 068**	**4 566**	**0.9**
Gambia	1 426	11	126	368	258	4.4
Ghana	**20 922**	**239**	**88**	**7 624**	**364**	**4.4**
Guinea	8 480	246	34	3 632	428	3.8
Guinea Bissau	1 493	36	41	239	160	-0.9
Kenya	**31 987**	**580**	**55**	**14 376**	**449**	**1.6**
Lesotho	1 802	30	59	1 128	626	3.3
Liberia	3 367	111	30	...	...	...
Libya	5 551	1 760	3	24 129	4 347	2.6
Madagascar	**17 404**	**587**	**30**	**5 474**	**315**	**2.8**
Malawi	12 105	118	102	1 718	142	2.7
Mali	**13 007**	**1 240**	**10**	**4 218**	**324**	**5.7**

Table 1 - **Basic Indicators, 2003** *(cont.)*

	Population (thousands)	Land Area (thousands of km²)	Population Density (pop / km²)	Gross Domestic Product (Current price, $ million)	GDP per Capita (Current price, $)	Annual Real GDP Growth (average over 1996-2003)
Mauritania	2 893	1 026	3	1 129	390	4.7
Mauritius	**1 221**	**2**	**599**	**5 651**	**4 628**	**5.0**
Morocco	**30 566**	**447**	**68**	**43 727**	**1 431**	**4.2**
Mozambique	**18 863**	**802**	**24**	**4 321**	**229**	**8.4**
Namibia	1 987	824	2	4 271	2 149	3.2
Niger	**11 972**	**1 267**	**9**	**2 731**	**228**	**3.8**
Nigeria	**124 009**	**924**	**134**	**58 390**	**471**	**4.0**
Rwanda	**8 387**	**26**	**318**	**1 684**	**201**	**8.3**
São Tomé and Principe	161	1	167	60	370	3.1
Senegal	**10 095**	**197**	**51**	**6 417**	**636**	**5.0**
Seychelles	84	0.455	184	695	8 317	4.3
Sierra Leone	4 971	72	69	984	198	4.7
Somalia	9 890	638	16	...	...	...
South Africa	**45 026**	**1 221**	**37**	**165 434**	**3 674**	**2.9**
Sudan	33 610	2 506	13	17 792	529	6.6
Swaziland	1 077	17	62	1 812	1 682	2.9
Tanzania	**36 977**	**945**	**39**	**10 297**	**278**	**5.1**
Togo	4 909	57	86	1 839	375	2.7
Tunisia	**9 832**	**164**	**60**	**25 000**	**2 543**	**5.0**
Uganda*	**25 827**	**241**	**107**	**6 319**	**245**	**6.0**
Zambia	**10 812**	**753**	**14**	**4 335**	**401**	**3.4**
Zimbabwe	12 891	391	33	7 904	613	-2.3
Africa	**849 491**	**30 043**	**28**	**669 710**	**788**	**3.8**

Note: * Fiscal year July (n-1)/June (n) ** Fiscal year April (n)/ March (n+1).

Sources: Population: United Nations, Department of Economic and Social Affairs, Population Division, *World Population Prospects, The 2002 Revision.*
Land Area: *African Development Indicators*, World Bank.
GDP: Various domestic authorities and IMF *World Economic Outlook.*

Table 2 - **Real GDP Growth Rates, 1996-2006**	1996	1997	1998	1999	2000	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Algeria	**3.8**	**1.1**	**5.1**	**3.2**	**2.2**	**2.6**	**4.0**	**6.9**	**5.4**	**4.5**	**4.5**
Angola	**11.2**	**7.9**	**6.8**	**3.2**	**3.0**	**3.1**	**14.4**	**3.4**	**10.9**	**14.7**	**25.4**
Benin	**4.3**	**5.7**	**4.0**	**5.3**	**4.9**	**6.2**	**4.4**	**3.9**	**2.2**	**3.1**	**4.2**
Botswana**	**5.6**	**8.1**	**4.1**	**6.6**	**8.4**	**2.3**	**5.5**	**5.2**	**4.4**	**4.0**	**3.9**
Burkina Faso	**6.0**	**4.8**	**6.2**	**5.8**	**2.2**	**5.8**	**5.0**	**8.0**	**4.0**	**3.3**	**3.2**
Burundi	-8.4	0.4	4.8	-1.0	-0.9	2.1	4.5	-1.2	5.5	5.0	5.0
Cameroon	**5.0**	**5.0**	**5.1**	**4.5**	**4.9**	**4.3**	**4.3**	**4.3**	**4.1**	**3.8**	**3.1**
Cape Verde	4.0	8.5	8.0	10.9	8.1	6.1	5.0	5.3	4.0	6.0	7.0
Central Afr. Rep.	-4.0	7.5	3.9	3.6	1.8	0.3	-0.6	-7.0	0.9	3.5	4.0
Chad	**2.2**	**5.6**	**7.0**	**-0.8**	**-0.6**	**10.4**	**8.4**	**12.5**	**31.3**	**10.8**	**4.7**
Comoros	-1.3	4.2	1.2	1.9	2.4	2.3	2.3	2.1	1.9	3.0	3.5
Congo	**4.3**	**-0.6**	**3.7**	**-3.0**	**8.2**	**3.6**	**5.4**	**0.8**	**4.0**	**9.4**	**4.3**
Congo Dem. Rep.	**-1.1**	**-5.4**	**-1.7**	**-4.3**	**-6.9**	**-2.1**	**3.5**	**5.7**	**6.8**	**7.0**	**7.0**
Côte d'Ivoire	**6.9**	**5.7**	**4.8**	**1.6**	**-2.3**	**0.1**	**-1.6**	**-1.7**	**-2.0**	**-1.1**	**1.5**
Djibouti	-3.3	-0.7	0.1	2.2	0.7	1.9	2.6	3.5	3.0	3.9	4.3
Egypt *	**5.0**	**5.3**	**5.6**	**6.1**	**5.4**	**3.5**	**3.2**	**3.2**	**4.3**	**4.6**	**4.8**
Equatorial Guinea	32.2	82.0	22.6	27.0	18.0	52.3	12.4	11.0	59.8	-4.7	9.7
Eritrea	9.3	7.9	1.8	0.0	-13.1	9.2	0.6	3.0	1.8	0.7	0.1
Ethiopia*	**10.2**	**5.1**	**-1.4**	**6.0**	**5.4**	**7.7**	**1.6**	**-3.9**	**11.5**	**5.8**	**4.9**
Gabon	**3.6**	**5.7**	**3.5**	**-8.9**	**-1.9**	**2.0**	**0.0**	**2.8**	**1.6**	**1.7**	**1.4**
Gambia	2.2	4.9	6.5	6.4	5.5	5.8	-3.2	6.7	7.7	5.0	4.8
Ghana	**4.6**	**4.2**	**4.7**	**4.4**	**3.7**	**4.2**	**4.5**	**5.2**	**5.8**	**5.9**	**5.7**
Guinea	4.6	4.9	4.8	4.7	1.9	4.0	4.2	1.2	2.5	3.2	4.8
Guinea Bissau	4.6	6.5	-27.2	7.6	7.5	0.2	-7.2	0.6	1.0	3.4	3.9
Kenya	**4.1**	**2.1**	**1.6**	**1.3**	**-0.2**	**1.2**	**1.2**	**1.8**	**3.1**	**3.5**	**3.9**
Lesotho	10.0	4.8	-3.5	0.5	1.9	3.3	4.5	5.2	2.3	2.4	3.0
Liberia	...	...	...	...	...	...	...	...	...	...	...
Libya	2.7	4.3	-1.3	0.4	2.4	2.9	3.7	5.3	0.9	4.3	4.4
Madagascar	**2.1**	**3.7**	**3.9**	**4.7**	**4.7**	**6.0**	**-12.7**	**9.8**	**5.3**	**6.0**	**6.7**
Malawi	7.3	6.6	1.1	3.5	0.8	-4.1	2.1	3.9	4.3	4.8	5.1
Mali	**6.8**	**4.9**	**8.0**	**5.7**	**-3.2**	**11.9**	**3.9**	**7.4**	**2.1**	**5.7**	**5.9**

Table 2 - Real GDP Growth Rates, 1996-2006 *(cont.)*

	1996	1997	1998	1999	2000	2001	2002	2003	2004 (e)	2005 (p)	2006 (p)
Mauritania	5.7	2.8	3.9	5.2	5.2	4.4	4.1	6.6	5.2	5.8	47.0
Mauritius	**5.6**	**5.7**	**6.0**	**2.8**	**8.6**	**5.2**	**2.0**	**4.3**	**4.1**	**4.3**	**4.0**
Morocco	**12.2**	**-2.2**	**7.7**	**-0.1**	**1.0**	**6.3**	**3.2**	**5.5**	**3.5**	**3.3**	**3.8**
Mozambique	**7.1**	**11.1**	**12.6**	**7.5**	**1.5**	**13.0**	**7.4**	**7.1**	**7.8**	**7.7**	**6.7**
Namibia	3.2	4.2	3.3	3.4	3.5	2.2	2.5	3.7	4.4	3.6	3.8
Niger	**3.4**	**2.8**	**10.4**	**-0.6**	**-1.4**	**7.1**	**3.0**	**5.3**	**1.0**	**4.2**	**4.0**
Nigeria	**6.6**	**3.2**	**0.3**	**1.5**	**5.4**	**3.1**	**1.5**	**10.7**	**3.7**	**6.2**	**5.4**
Rwanda	**12.8**	**13.8**	**8.9**	**7.6**	**6.0**	**6.7**	**9.4**	**0.9**	**4.0**	**5.0**	**4.3**
São Tomé and Principe	1.5	1.0	2.5	2.5	3.0	4.0	5.0	5.5	6.1	7.1	9.2
Senegal	**5.1**	**5.0**	**5.7**	**5.0**	**5.6**	**5.6**	**1.1**	**6.5**	**6.0**	**6.3**	**5.0**
Seychelles	4.9	12.2	5.7	14.3	4.3	-2.2	1.3	-6.3	-2.0	-5.0	3.0
Sierra Leone	6.1	-17.6	-0.8	-8.1	3.8	18.1	27.5	8.6	7.4	7.5	7.1
Somalia	...	...	...	...	...	...	...	...	...	...	...
South Africa	**4.3**	**2.6**	**0.5**	**2.4**	**4.2**	**2.7**	**3.6**	**2.8**	**3.8**	**4.1**	**3.9**
Sudan	6.3	9.3	5.7	6.5	6.9	6.1	6.0	6.0	7.3	8.3	8.6
Swaziland	3.9	3.8	3.3	3.5	2.0	1.7	2.8	2.4	2.1	2.0	1.7
Tanzania	**4.5**	**3.5**	**3.7**	**3.5**	**5.1**	**6.2**	**7.2**	**7.1**	**7.4**	**7.5**	**7.6**
Togo	8.8	3.5	-2.3	2.4	-0.4	0.6	4.5	4.4	2.9	3.0	3.0
Tunisia	**7.1**	**5.4**	**4.8**	**6.1**	**4.7**	**4.9**	**1.7**	**5.6**	**5.5**	**5.2**	**5.0**
Uganda*	**9.1**	**5.5**	**3.6**	**8.1**	**5.6**	**4.9**	**6.8**	**4.7**	**5.9**	**5.3**	**5.3**
Zambia	**6.9**	**3.3**	**-1.9**	**2.2**	**3.6**	**4.9**	**3.2**	**5.1**	**5.1**	**5.1**	**5.3**
Zimbabwe	9.7	1.4	0.1	-3.6	-7.3	-2.7	-6.0	-10.0	-4.8	-1.6	0.0
Africa	**5.6**	**3.6**	**3.2**	**3.2**	**3.4**	**3.9**	**3.5**	**4.4**	**5.1**	**4.7**	**5.2**

Note: * Fiscal year July (n-1)/June (n) ** Fiscal year April (n)/ March (n+1).
Sources: Various domestic authorities; IMF *World Economic Outlook* and authors' estimates and forecasts.

Table 3 - **Demand Composition, 2003** (percentage of GDP)

	Final Consumption			Gross Capital Formation			External Sector		
	Total	Private	Public	Total	Private	Public	Balance	Exports	Imports
Algeria	**55.2**	**41.1**	**14.1**	**29.8**	**18.8**	**11.0**	**15.0**	**39.0**	**23.9**
Angola	**64.2**	**33.4**	**30.8**	**40.2**	**33.9**	**6.3**	**-4.4**	**73.9**	**78.3**
Benin	**89.8**	**77.2**	**12.6**	**20.3**	**12.8**	**7.5**	**-10.1**	**21.0**	**31.1**
Botswana**	**62.8**	**25.5**	**37.3**	**25.5**	**14.3**	**11.2**	**11.6**	**44.6**	**32.9**
Burkina Faso	**93.2**	**72.4**	**20.9**	**18.8**	**9.6**	**9.2**	**-12.1**	**9.0**	**21.1**
Burundi	104.2	86.4	17.8	16.2	3.0	13.2	-20.4	9.7	30.1
Cameroon	**80.6**	**70.8**	**9.8**	**15.9**	**13.6**	**2.3**	**3.5**	**23.1**	**19.6**
Cape Verde	114.3	88.7	25.5	18.2	13.5	4.7	-32.5	33.2	65.6
Central African Republic	99.9	89.5	10.5	6.0	3.9	2.1	-6.0	11.1	17.1
Chad	**79.1**	**46.2**	**32.9**	**44.1**	**36.2**	**7.9**	**-23.2**	**25.7**	**48.9**
Comoros	101.0	87.0	14.1	12.2	6.5	5.6	-13.0	16.8	29.8
Congo	**51.7**	**34.4**	**17.3**	**23.2**	**16.6**	**6.6**	**25.0**	**78.8**	**53.8**
Congo. Dem. Rep.	**94.3**	**88.5**	**5.8**	**12.3**	**9.6**	**2.7**	**-6.6**	**25.3**	**31.9**
Côte d'Ivoire	**75.6**	**60.2**	**15.4**	**9.6**	**7.3**	**2.3**	**14.9**	**42.8**	**27.9**
Djibouti	104.2	49.0	55.2	15.5	8.8	6.7	-19.7	48.8	68.5
Egypt*	**85.5**	**73.0**	**12.5**	**17.1**	**12.6**	**4.6**	**-2.7**	**21.7**	**24.4**
Equatorial Guinea	39.0	32.9	6.2	25.5	21.1	4.4	35.4	100.7	65.3
Eritrea	147.5	95.8	51.7	37.9	20.1	17.8	-85.4	13.7	99.1
Ethiopia*	**99.0**	**79.9**	**19.1**	**20.5**	**10.0**	**10.5**	**-19.4**	**17.1**	**36.5**
Gabon	**51.7**	**37.4**	**14.3**	**29.7**	**22.7**	**7.0**	**18.6**	**56.0**	**37.4**
Gambia	90.1	75.2	14.9	20.0	13.9	6.1	-10.1	46.5	56.6
Ghana	**88.8**	**71.3**	**17.5**	**23.2**	**14.0**	**9.2**	**-12.1**	**40.7**	**52.8**
Guinea	92.6	85.2	7.5	9.9	6.2	3.8	-2.5	22.0	24.6
Guinea Bissau	104.0	87.8	16.2	11.1	0.1	11.0	-15.2	28.5	43.7
Kenya	**91.7**	**73.8**	**17.9**	**12.9**	**8.5**	**4.4**	**-4.6**	**24.9**	**29.5**
Lesotho	113.6	81.8	31.8	34.1	26.6	7.6	-47.8	47.3	95.0
Liberia	...	...	...	...	...	...	...	...	...
Libya	70.1	52.4	17.7	10.5	2.4	8.1	19.4	50.5	31.1
Madagascar	**97.1**	**86.6**	**10.5**	**16.2**	**9.0**	**7.2**	**-13.3**	**19.9**	**33.3**
Malawi	105.5	77.4	28.1	9.9	1.6	8.4	-15.4	26.8	42.2
Mali	**83.3**	**67.6**	**15.7**	**24.5**	**17.3**	**7.2**	**-7.8**	**23.5**	**31.3**

Table 3 - **Demand Composition, 2003** (percentage of GDP) *(cont.)*

	Final Consumption			Gross Capital Formation			External Sector		
	Total	Private	Public	Total	Private	Public	Balance	Exports	Imports
Mauritania	101.1	82.5	18.6	24.9	5.9	19.0	-26.0	31.4	57.4
Mauritius	**75.1**	**62.2**	**12.9**	**23.6**	**14.8**	**8.8**	**1.3**	**56.3**	**55.0**
Morocco	**81.3**	**61.3**	**19.9**	**23.2**	**20.6**	**2.6**	**-4.4**	**31.1**	**35.5**
Mozambique	**68.0**	**53.7**	**14.3**	**44.7**	**30.4**	**14.3**	**-12.7**	**33.0**	**45.6**
Namibia	85.5	56.6	28.8	22.7	14.3	8.5	-8.2	37.6	45.8
Niger	**95.0**	**83.7**	**11.3**	**14.2**	**5.9**	**8.3**	**-9.2**	**16.0**	**25.2**
Nigeria	**68.3**	**45.0**	**23.3**	**22.8**	**13.4**	**9.3**	**8.9**	**49.9**	**41.0**
Rwanda	**100.8**	**85.7**	**15.1**	**18.4**	**12.8**	**5.6**	**-19.3**	**8.3**	**27.6**
São Tomé and Principe	108.2	68.6	39.6	30.4	14.0	16.4	-38.7	38.3	76.9
Senegal	**92.6**	**82.0**	**10.6**	**19.5**	**11.0**	**8.5**	**-12.2**	**28.8**	**40.9**
Seychelles	79.6	43.8	35.8	19.0	16.7	2.3	1.4	79.3	77.9
Sierra Leone	102.4	86.7	15.7	17.0	12.2	4.9	-19.5	18.6	38.0
Somalia	...	...	...	...	...	...	...	...	...
South Africa* **	**81.6**	**62.6**	**18.9**	**16.8**	**12.1**	**4.7**	**1.6**	**27.2**	**25.5**
Sudan	86.1	75.5	10.6	18.2	15.2	2.9	-4.2	14.7	18.9
Swaziland	90.2	64.9	25.3	19.4	11.0	8.4	-9.7	83.9	93.6
Tanzania	**90.3**	**83.8**	**6.5**	**18.6**	**11.2**	**7.4**	**-9.0**	**17.8**	**26.7**
Togo	99.2	90.1	9.0	14.5	13.3	1.1	-13.6	40.1	53.7
Tunisia	**78.8**	**62.8**	**16.1**	**25.0**	**17.7**	**7.4**	**-3.9**	**43.8**	**47.6**
Uganda*	**93.7**	**78.5**	**15.1**	**20.6**	**16.0**	**4.7**	**-14.3**	**12.4**	**26.7**
Zambia	**84.8**	**70.1**	**14.6**	**26.1**	**14.7**	**11.5**	**-10.9**	**31.0**	**41.9**
Zimbabwe	105.6	88.5	17.1	1.9	0.0	1.9	-7.4	16.1	23.5

Note: * Fiscal year July (n-1)/June (n)
** Fiscal year April (n)/ March (n+1).
*** Residual Items Reported by the South African Reserve Bank has been reallocated in the domestic expenditure items.
Sources: Various domestic authorities and IMF World Economic Outlook.

Table 4 - **Public Finances, 2003** (percentage of GDP)

	Total revenue and grants***	°Tax revenue	Grants	Total expenditure and net lending***	Current expenditure	*Wages and salaries*	*Interest payments*	Capital expenditure	Primary balance	Overall balance
Algeria	39.2	9.7	0.1	34.0	22.6	7.4	2.3	10.8	7.4	5.1
Angola	37.3	7.8	0.8	45.1	36.7	12.5	1.8	7.4	-6.0	-7.8
Benin	18.5	14.9	2.0	21.1	14.2	5.0	0.6	7.0	-2.0	-2.6
Botswana**	44.8	38.6	0.5	44.5	35.1	10.7	0.3	10.5	0.6	0.3
Burkina Faso	17.7	11.0	5.4	20.6	10.5	4.6	0.7	9.1	-2.2	-2.9
Burundi	29.0	...	...	35.3	...	...	4.3	...	-2.0	-6.3
Cameroon	17.1	14.6	0.5	15.3	13.2	5.2	2.3	2.1	4.0	1.8
Cape Verde	26.3	...	...	29.6	...	...	2.5	...	-0.8	-3.3
Central African Republic	9.2	...	...	12.3	...	...	1.1	...	-2.0	-3.1
Chad	16.6	7.6	8.4	22.2	9.4	3.6	0.6	12.8	-5.0	-5.6
Comoros	14.9	...	...	19.0	...	...	1.1	...	-3.0	-4.1
Congo	30.1	8.7	0.5	29.7	23.1	5.9	5.8	6.6	6.1	0.4
Congo, Dem. Rep.	9.8	6.9	2.0	13.7	11.0	2.5	3.5	2.7	-0.4	-3.9
Côte d'Ivoire	16.9	14.6	0.3	19.7	17.0	6.6	2.7	2.6	-0.2	-2.9
Djibouti	34.2	...	...	36.5	...	...	0.4	...	-1.9	-2.3
Egypt *	20.8	14.4	0.7	27.0	22.9	7.6	6.5	4.0	0.3	-6.1
Equatorial Guinea	33.8	...	...	10.5	...	...	0.1	...	23.4	23.3
Eritrea	42.0	...	...	55.1	...	...	2.8	...	-10.2	-13.1
Ethiopia*	27.5	14.4	8.0	35.9	23.7	7.0	2.1	11.1	-6.3	-8.4
Gabon	29.8	12.3	0.0	22.4	18.7	6.5	4.0	3.7	11.4	7.4
Gambia	17.4	...	...	21.9	...	...	5.8	...	1.3	-4.5
Ghana	25.5	20.2	4.7	29.0	20.0	8.4	6.2	8.9	2.7	-3.5
Guinea	13.2	...	...	18.3	...	...	2.1	...	-3.0	-5.1
Guinea Bissau	23.3	...	...	37.2	...	...	4.7	...	-9.2	-14.0
Kenya*	22.1	17.5	1.5	24.1	20.8	8.7	3.5	3.3	1.4	-2.0
Lesotho	45.4	...	...	44.6	...	...	2.7	...	3.5	0.8
Liberia	...	...	...	...	...	...	...	...	...	...
Libya	52.4	...	...	40.6	...	...	0.0	...	11.8	11.8
Madagascar	15.3	10.0	5.1	19.5	11.7	5.4	2.2	7.8	-1.8	-4.2
Malawi	31.2	...	...	36.5	...	...	1.6	...	-3.7	-5.3

Table 4 - **Public Finances, 2003** (percentage of GDP) *(cont.)*

	Total revenue and grants***	°Tax revenue	Grants	Total expenditure and net lending***	Current expenditure	*Wages and salaries*	*Interest payments*	Capital expenditure	Primary balance	Overall balance
Mali	**21.8**	**14.2**	**4.6**	**22.5**	**14.4**	**4.3**	**0.8**	**8.2**	**0.1**	**-0.7**
Mauritania	32.1	...	...	31.4	...	...	2.7	...	3.4	0.7
Mauritius*	**20.2**	**17.3**	**0.2**	**26.4**	**21.0**	**6.2**	**4.3**	**4.7**	**-1.9**	**-6.2**
Morocco	**27.0**	**22.1**	**1.6**	**29.6**	**25.0**	**12.7**	**4.1**	**4.6**	**1.6**	**-2.5**
Mozambique	**24.9**	**13.3**	**10.6**	**29.8**	**16.3**	**7.5**	**1.3**	**13.0**	**-3.7**	**-4.9**
Namibia	33.2	...	...	36.8	...	...	2.4	...	-1.2	-3.6
Niger	**14.7**	**9.0**	**4.8**	**17.4**	**10.1**	**3.6**	**1.1**	**7.3**	**-1.6**	**-2.7**
Nigeria	**36.5**	**7.9**	**0.0**	**37.9**	**13.6**	**4.9**	**5.1**	**9.3**	**3.7**	**-1.4**
Rwanda	**21.6**	**12.7**	**8.1**	**24.1**	**18.0**	**4.9**	**1.2**	**5.6**	**-1.3**	**-2.5**
São Tomé and Principe	50.3	...	...	63.8	...	...	5.4	...	-8.0	-13.4
Senegal	**21.4**	**18.5**	**2.7**	**22.8**	**13.9**	**5.5**	**1.2**	**9.1**	**-0.2**	**-1.4**
Seychelles	50.0	...	...	48.1	...	...	8.1	...	10.1	2.0
Sierra Leone	24.5	...	...	32.2	...	...	4.2	...	-3.4	-7.6
Somalia	...	...	...	...	...	...	...	...	...	...
South Africa**	**24.3**	**23.8**	**0.0**	**26.7**	**27.0**	**9.8**	**3.8**	**1.3**	**1.4**	**-2.4**
Sudan	16.0	...	...	15.1	...	...	1.6	...	2.5	0.9
Swaziland	27.8	...	...	34.0	...	...	1.1	...	-5.1	-6.3
Tanzania*	**18.3**	**11.0**	**6.2**	**19.9**	**14.9**	**4.0**	**1.0**	**5.0**	**-0.6**	**-1.6**
Togo	14.9	...	...	13.6	...	...	1.6	...	2.9	1.3
Tunisia	**24.0**	**20.7**	**0.2**	**27.2**	**19.6**	**12.2**	**3.0**	**7.2**	**-0.2**	**-3.2**
Uganda*	**19.1**	**11.3**	**7.0**	**23.3**	**13.6**	**5.1**	**1.5**	**9.8**	**-2.8**	**-4.3**
Zambia	**25.1**	**17.5**	**7.0**	**31.1**	**19.6**	**8.5**	**3.9**	**11.5**	**-2.1**	**-6.0**
Zimbabwe	26.3	...	...	26.6	...	...	1.3	...	1.1	-0.3

Note: * Fiscal year July (n-1)/June (n)
** Fiscal year April (n)/ March (n+1).
*** Only major Items are reported.
° Excluding oil revenues (for oil producing countries).
Sources: Various domestic authorities and IMF World Economic Outlook.

Table 5 - **Monetary Indicators**

	Inflation (%)				Exchange Rate (LCU / $)			Broad Money (LCU billion) 2003			Reserves excluding gold ($ million) 2003	
	2003	2004 (e)	2005 (p)	2006 (p)	2002	2003	2004	Level	% of GDP	Growth 2002/2003	Stock at year-end	Eq. months of imports
Algeria	**2.6**	**4.0**	**3.6**	**3.2**	**79.7**	**77.4**	**72.1**	**3 290.4**	**64.2**	**16.0**	**33 415.6**	**30.1**
Angola	**98.3**	**40.8**	**30.6**	**26.5**	**43.5**	**74.6**	**83.6**	**178.7**	**17.3**	**64.6**	**634.2**	**1.4**
Benin	**1.5**	**0.1**	**2.5**	**2.2**	**697.0**	**581.2**	**528.3**	**444.2**	**22.0**	**-11.3**	**509.8**	**9.4**
Botswana**	**6.3**	**6.5**	**6.0**	**6.2**	**6.3**	**4.9**	**4.7**	**11.0**	**30.0**	**15.5**	**5 339.8**	**31.4**
Burkina Faso	**2.0**	**-0.4**	**2.6**	**2.3**	**697.0**	**581.2**	**528.3**	**471.8**	**19.0**	**19.0**	**434.8**	**7.6**
Burundi	10.7	7.9	8.2	5.3	930.7	1 082.6	1 100.9	172.7	26.8	15.8	67.4	6.2
Cameroon	**0.6**	**0.2**	**2.2**	**2.5**	**697.0**	**581.2**	**528.3**	**1 359.4**	**18.7**	**1.3**	**652.2**	**3.7**
Cape Verde	1.2	-1.9	2.4	2.0	117.3	97.8	88.5	55.4	68.2	9.0	93.6	3.3
Central African Republic	4.2	-2.2	2.5	2.5	697.0	581.2	528.3	96.5	13.9	-8.0	137.1	14.4
Chad	**-1.8**	**-4.8**	**4.5**	**2.7**	**697.0**	**581.2**	**528.3**	**182.3**	**11.9**	**-3.1**	**191.8**	**2.8**
Comoros	4.5	4.3	3.0	3.0	522.7	435.9	396.2	33.9	25.2	-1.2	94.5	19.5
Congo	**1.2**	**2.0**	**2.1**	**1.7**	**697.0**	**581.2**	**528.3**	**284.6**	**13.7**	**-2.4**	**39.4**	**1.1**
Congo. Dem. Rep.	**12.8**	**8.5**	**8.0**	**7.0**	**346.5**	**405.3**	**390.3**	**124.5**	**5.4**	**244.0**	**...**	**...**
Côte d'Ivoire	**3.5**	**1.9**	**1.4**	**1.5**	**697.0**	**581.2**	**528.3**	**2 245.0**	**27.6**	**-6.1**	**2 230.5**	**8.1**
Djibouti	2.0	3.0	3.0	2.2	177.7	177.7	177.7	77.1	69.4	17.8	100.1	3.5
Egypt*	**3.2**	**8.1**	**7.7**	**6.6**	**4.5**	**5.9**	**6.2**	**403.6**	**97.3**	**21.3**	**14 219.7**	**12.9**
Equatorial Guinea	7.6	8.0	6.0	6.0	697.0	581.2	528.3	155.2	9.0	56.7	237.7	1.6
Eritrea	22.7	21.4	20.4	18.8	14.0	13.9	13.8	17.7	169.5	15.1	24.7	0.6
Ethiopia*	**15.1**	**9.1**	**5.8**	**5.0**	**8.6**	**8.6**	**8.6**	**33.2**	**58.2**	**12.4**	**955.6**	**5.9**
Gabon	**2.1**	**1.5**	**2.5**	**2.5**	**697.0**	**581.2**	**528.3**	**591.8**	**16.8**	**-1.2**	**201.9**	**2.2**
Gambia	17.0	14.6	7.1	5.2	19.9	...	...	...	...	...	...	...
Ghana	**26.7**	**13.0**	**13.0**	**9.1**	**7 932.7**	**8 677.4**	**9 004.6**	**20 123.0**	**30.4**	**34.2**	**1 468.9**	**5.4**
Guinea	12.9	17.5	22.6	9.6	1 975.8	1 984.9	1 996.2	1 099.3	15.2	33.2	...	...
Guinea Bissau	3.0	3.0	3.0	3.0	697.0	581.2	528.3	98.8	71.2	14.4	164.4	27.9
Kenya	**9.8**	**11.1**	**6.2**	**5.4**	**78.7**	**75.9**	**79.2**	**439.4**	**41.4**	**11.9**	**1 482.1**	**5.0**
Lesotho	7.6	5.5	5.5	5.5	10.5	7.6	6.5	2.3	26.9	6.0	460.3	5.2
Liberia	...	...	...	...	61.8	59.4	54.3	...	...	...	...	...
Libya	-2.1	-1.0	1.8	2.4	1.3	1.3	1.3	10.8	34.7	7.8	19 778.2	38.0
Madagascar	**-1.7**	**13.8**	**5.5**	**5.0**	**6 832.0**	**6 191.6**	**9 344.3**	**7 934.7**	**23.4**	**8.8**	**414.3**	**4.5**
Malawi	9.6	11.6	12.3	9.0	76.7	97.4	108.9	35.8	21.4	27.5	127.0	2.9
Mali	**-1.3**	**-3.0**	**2.9**	**2.3**	**697.0**	**581.2**	**528.3**	**764.8**	**30.1**	**22.7**	**908.7**	**12.6**

Table 5 - **Monetary Indicators** *(cont.)*

	Inflation (%)				Exchange Rate (LCU / $)			Broad Money (LCU billion) 2003			Reserves excluding gold ($ million) 2003	
	2003	2004 (e)	2005 (p)	2006 (p)	2002	2003	2004	Level	% of GDP	Growth 2002/2003	Stock at year-end	Eq. months of imports
Mauritania	5.5	10.4	14.2	6.0	271.7	263.0	265.5	46.5	15.7	10.5	419.3	11.5
Mauritius	**3.9**	**4.7**	**5.1**	**4.4**	**30.0**	**27.9**	**27.5**	**131.2**	**88.1**	**10.9**	**1 598.4**	**8.7**
Morocco	**1.2**	**2.3**	**2.6**	**1.8**	**11.0**	**9.6**	**8.9**	**386.3**	**90.8**	**8.7**	**14 075.1**	**12.9**
Mozambique	**13.5**	**12.8**	**9.1**	**7.1**	**23 678.0**	**23 782.3**	**22 581.3**	**32 894.4**	**32.0**	**18.3**	**998.5**	**9.8**
Namibia	7.2	5.5	5.8	5.0	10.5	7.6	6.5	12.9	40.0	20.7	325.2	2.3
Niger	**-1.8**	**0.6**	**2.9**	**1.8**	**697.0**	**581.2**	**528.3**	**118.1**	**7.4**	**-13.2**	**114.1**	**2.9**
Nigeria	**16.1**	**13.4**	**12.1**	**8.0**	**120.6**	**129.2**	**132.9**	**1 985.2**	**26.4**	**24.1**	**7 128.6**	**5.1**
Rwanda	**7.4**	**10.9**	**7.6**	**4.1**	**476.3**	**537.7**	**574.6**	**165.0**	**18.2**	**15.4**	**214.7**	**10.6**
São Tomé and Principe	9.8	13.3	15.0	12.4	9 088.3	9 347.6	9 812.5	299.7	53.8	52.4	25.5	11.2
Senegal	**0.1**	**0.3**	**2.1**	**1.7**	**697.0**	**581.2**	**528.3**	**1 111.9**	**29.8**	**14.6**	**794.5**	**4.7**
Seychelles	7.0	4.0	4.0	5.0	5.5	5.4	5.5	4.2	113.2	5.9	67.4	2.3
Sierra Leone	8.2	13.7	8.5	7.4	2 099.0	2 347.9	2 701.3	459.3	19.9	21.9	66.6	2.6
Somalia	...	...	...	...	...	...	...	...	...	...	...	...
South Africa	**6.8**	**4.3**	**5.7**	**5.1**	**10.5**	**7.6**	**6.5**	**777.7**	**64.3**	**12.5**	**7 971.2**	**2.7**
Sudan	7.7	8.4	7.5	7.0	263.3	261.0	...	734.1	15.8	30.3	847.5	3.8
Swaziland	7.3	3.5	5.5	5.8	10.5	7.6	6.5	3.0	21.7	14.1	277.5	2.2
Tanzania	**4.3**	**4.6**	**4.3**	**4.0**	**966.6**	**1 038.4**	**1 089.3**	**2 388.3**	**22.3**	**16.6**	**2 038.4**	**14.7**
Togo	-0.9	1.2	1.7	2.0	697.0	581.2	528.3	248.4	23.2	5.9	182.5	2.7
Tunisia	**2.7**	**3.5**	**3.2**	**2.2**	**1.4**	**1.3**	**1.2**	**18.1**	**56.2**	**6.4**	**2 949.0**	**3.4**
Uganda*	**5.7**	**5.1**	**5.3**	**5.6**	**1 797.6**	**1 963.7**	**1 810.3**	**2 428.7**	**18.4**	**17.9**	**1 080.3**	**10.3**
Zambia	**21.4**	**18.3**	**17.7**	**14.0**	**4 398.6**	**4 733.3**	**4 778.9**	**4 440.8**	**21.6**	**22.7**	**247.7**	**2.1**
Zimbabwe	431.7	282.4	187.2	103.7	55.0	697.4	4 873.9	2 803.8	48.3	430.0	...	...

Note: * Fiscal year July (n-1)/June (n) ** Fiscal year April (n)/ March (n+1).
Sources: Inflation: Various domestic authorities; IMF *World Economic Outlook* and authors' estimates and forecasts.
Other data: IMF, *International Financial Statistics.*

Table 6 - **Current Account, 2003** (percentage of GDP)

	Trade balance	Exports of goods	Imports of goods	Services balance	Net income	Current transfers	Current account balance
Algeria	**16.7**	**36.8**	**-20.1**	**-2.0**	**-4.1**	**2.6**	**13.2**
Angola	**29.2**	**68.8**	**-39.6**	**-22.6**	**-12.5**	**0.7**	**-5.2**
Benin	**-8.6**	**14.2**	**-22.8**	**-1.8**	**-0.5**	**4.8**	**-6.2**
Botswana**	**16.8**	**42.9**	**-26.1**	**-0.1**	**-6.1**	**1.8**	**12.4**
Burkina Faso	**-8.5**	**7.7**	**-16.2**	**-3.5**	**-0.5**	**5.2**	**-7.4**
Burundi	-15.5	6.3	-21.8	-6.6	-2.9	18.8	-6.3
Cameroon	**1.3**	**16.9**	**-15.6**	**-3.7**	**-2.6**	**1.7**	**-3.3**
Cape Verde	-35.0	6.4	-41.4	2.5	-2.0	25.2	-9.3
Central African Republic	0.3	9.8	-9.5	-6.3	-0.6	1.3	-5.2
Chad	**-15.9**	**17.6**	**-33.5**	**-17.5**	**-10.2**	**3.2**	**-40.4**
Comoros	-8.6	10.3	-18.9	-4.6	-0.2	8.9	-4.5
Congo	**49.2**	**72.3**	**-23.1**	**-24.3**	**-25.2**	**0.2**	**-0.1**
Congo. Dem. Rep.	**0.2**	**23.0**	**-22.8**	**...**	**...**	**...**	**...**
Côte d'Ivoire	**18.2**	**41.2**	**-23.0**	**-7.3**	**-5.0**	**-3.4**	**2.5**
Djibouti	-39.5	15.7	-55.2	19.8	6.5	7.0	-6.2
Egypt*	**-8.3**	**10.2**	**-18.5**	**6.3**	**-0.1**	**4.5**	**2.4**
Equatorial Guinea	39.1	100.6	-61.5	-3.6	-35.8	0.0	-0.3
Eritrea	-59.2	6.1	-65.2	-7.0	-0.7	55.0	-11.9
Ethiopia*	**-20.6**	**7.3**	**-27.9**	**2.9**	**-0.8**	**15.9**	**-2.7**
Gabon	**35.6**	**53.5**	**-17.9**	**-21.3**	**-3.2**	**-1.5**	**9.6**
Gambia	-16.3	27.4	-43.8	7.6	-6.3	10.1	-5.0
Ghana	**-10.3**	**32.4**	**-42.7**	**-3.6**	**-2.1**	**18.4**	**2.4**
Guinea	-1.0	16.8	-17.7	-4.8	-3.1	3.7	-5.2
Guinea Bissau	-4.7	25.0	-29.7	-10.5	-4.4	16.1	-3.5
Kenya	**-7.9**	**16.9**	**-24.8**	**3.2**	**-0.6**	**5.7**	**0.4**
Lesotho	-47.7	46.0	-93.7	-3.5	22.9	16.3	-11.9
Liberia	...	...	...	...	...	...	...
Libya	24.2	50.1	-25.9	-4.6	2.7	-8.6	13.7
Madagascar	**-4.0**	**14.4**	**-18.5**	**-4.0**	**-1.5**	**4.5**	**-5.0**
Malawi	-7.4	23.5	-31.0	-8.0	-2.6	9.8	-8.1
Mali	**2.4**	**22.9**	**-20.5**	**-6.9**	**-4.0**	**4.4**	**-4.2**

Table 6 - **Current Account, 2003** (percentage of GDP) *(cont.)*

	Trade balance	Exports of goods	Imports of goods	Services balance	Net income	Current transfers	Current account balance
Mauritania	-11.6	27.2	-38.8	-14.6	6.1	10.2	-9.9
Mauritius	**-5.3**	**33.6**	**-38.9**	**7.6**	**-0.6**	**1.1**	**2.8**
Morocco	**-9.9**	**19.6**	**-29.5**	**5.8**	**-1.7**	**9.5**	**3.7**
Mozambique	**-13.1**	**20.4**	**-33.4**	**-5.5**	**0.0**	**12.4**	**-6.2**
Namibia	-10.9	29.5	-40.4	2.6	5.3	9.3	6.3
Niger	**-4.9**	**12.3**	**-17.2**	**-6.4**	**-0.5**	**4.2**	**-7.6**
Nigeria	**18.0**	**47.0**	**-29.0**	**-9.0**	**-14.5**	**2.8**	**-2.7**
Rwanda	**-10.8**	**3.7**	**-14.5**	**-10.7**	**-1.5**	**12.1**	**-10.9**
São Tomé and Principe	-34.2	11.4	-45.6	-4.4	-5.1	7.6	-36.1
Senegal	**-11.1**	**20.5**	**-31.6**	**-1.0**	**-1.6**	**7.1**	**-6.7**
Seychelles	-14.0	36.3	-50.3	15.4	-4.5	0.3	-2.8
Sierra Leone	-20.5	11.1	-31.6	-2.6	-1.0	16.5	-7.6
Somalia	...	...	...	...	...	...	...
South Africa	**2.2**	**23.2**	**-21.0**	**-0.6**	**-2.0**	**-0.5**	**-0.9**
Sudan	-1.7	13.2	-14.9	-3.1	-3.3	3.9	-4.1
Swaziland	-7.5	74.5	-82.0	-2.2	2.6	2.9	-4.1
Tanzania	**-7.8**	**11.0**	**-18.8**	**-0.9**	**-0.5**	**5.1**	**-4.1**
Togo	-12.7	31.6	-44.3	-3.2	-2.0	6.4	-11.6
Tunisia	**-9.1**	**32.1**	**-41.2**	**7.3**	**-4.5**	**3.4**	**-2.9**
Uganda*	**-9.9**	**8.0**	**-17.9**	**-4.0**	**-2.5**	**12.5**	**-3.9**
Zambia	**-6.3**	**25.9**	**-32.2**	**-5.5**	**-3.4**	**0.7**	**-14.4**
Zimbabwe	-5.1	15.5	-20.6	-3.2	-3.5	6.9	-4.9
Africa***	2.8	27.4	-24.6	-1.3	-3.5	2.9	0.9

Note: * Fiscal year July (n-1)/June (n)
** Fiscal year April (n)/ March (n+1).
*** Excluding countries for which data are not available.

Sources: Domestic authorities and IMF *World Economic Outlook.*

Table 7 - Exports, 2002

	Three main exports, with their share in total exports*			No. of products accounting for more than 75 per cent of exports
	Product I	Product II	Product III	
Algeria	Crude petroleum (53.9%)	Natural gas, liquefied (17.1%)	Natural gas, gaseous (7.8%)	3
Angola	Crude petroleum (91.4%)	Diamonds.excl.industrial (7.0%)		1
Benin	Cotton,not carded,combed (49.6%)	Edible nuts fresh,dried (13.9%)	Goat or kid skin leather (8.2%)	4
Botswana	Diamonds.excl.industrial (87.9%)	Nickel mattes,sintrs.etc (4.2%)		1
Burkina Faso	Cotton,not carded,combed (31.9%)	Sugars,beet or cane, raw (6.9%)	Oth.manufactured tobacco (5.4%)	20
Burundi	Coffee, not roasted (77.2%)	Tea (5.1%)		1
Cameroon	Crude petroleum (43.9%)	Wood,non-conifer, sawn (14.7%)	Bananas, fresh or dried (8.1%)	5
Cape Verde	Gas turbines, nes (34.0%)	Parts footwear,etc. (21.7%)	Underwear,nightwear etc. (8.2%)	5
Central African Republic	Diamonds.excl.industrial (68.7%)	Wood,non-conif,rough,unt (14.8%)	Cotton,not carded,combed (6.1%)	2
Chad	Cotton,not carded,combed (76.1%)	Natural gums,resins,etc (15.1%)	Aircrft etc.ULW >15000kg (5.3%)	1
Comoros	Ships,boats,other vessels (46.7%)	Spices,ex.pepper,pimento (43.9%)	Essential oils (6.5%)	2
Congo	Crude petroleum (80.7%)	Wood,non-conif,rough,unt (7.2%)		1
Congo, Dem. Rep.	Diamonds.excl.industrial (73.7%)	Crude petroleum (12.3%)	Oth.non-ferr.ore,concntr (5.3%)	2
Côte d'Ivoire	Cocoa beans (44.2%)	Cocoa paste (8.0%)	Wood,non-conifer, sawn (5.6%)	8
Djibouti	Pass.transport vehicles (10.7%)	Sugars,beet or cane, raw (10.0%)	Legumes,dried,shelled (9.7%)	13
Egypt	Crude petroleum (15.1%)			44
Equatorial Guinea	Crude petroleum (90.1%)	Wood,non-conif,rough,unt (4.0%)		1
Eritrea	Oth.bovine,equine leather (14.5%)	Elctrn comp pts,crystals (10.0%)	Parts,data proc. etc.mch. (6.6%)	15
Ethiopia	Coffee, not roasted (36.8%)	Sesame (sesamum) seeds (7.7%)	Sheep skin without wool (6.6%)	5
Gabon	Crude petroleum (75.2%)	Wood,non-conif,rough,unt (13.9%)	Manganese ores,concentrs (5.2%)	1
Gambia	Animal oil,fat,grease nes (30.2%)	Edible nuts fresh,dried (13.4%)	Groundnuts (peanuts) (7.6%)	9
Ghana	Cocoa beans (38.7%)	Alum.,alum.alloy,unwrght (10.7%)	Wood,non-conifer, sawn (6.6%)	8
Guinea	Aluminium ore,concentrat (45.0%)	Crude petroleum (15.5%)	Alumina(aluminium oxide) (12.2%)	4
Guinea Bissau	Edible nuts fresh,dried (78.3%)	Fish,frozen ex.fillets (6.1%)	Helicopters (5.0%)	1
Kenya	Tea (25.8%)	Cut flowers and foliage (11.1%)	Oth.fresh,chll.vegetables (7.7%)	24
Lesotho	Jerseys,pullovers,etc.knit (35.0%)	Trousers,breeches,etc. (34.2%)	Suits,dresses,skirts etc (8.6%)	3
Liberia	Ships,boats,other vessels (65.7%)	Wood,non-conif,rough,unt (18.6%)	Natural rubber latex (6.6%)	2
Libya	Crude petroleum (82.4%)			1
Madagascar	Spices,ex.pepper,pimento (27.3%)	Crustaceans, frozen (17.0%)	Jersys,pullovrs,etc.knit (9.3%)	12
Malawi	Tobacco,stemmed,stripped (57.9%)	Tobacco,not stripped,etc (9.5%)	Tea (8.3%)	3

Table 7 - **Exports, 2002** *(cont.)*

	Three main exports, with their share in total exports*			No. of products accounting for more than 75 per cent of exports
	Product I	**Product II**	**Product III**	
Mauritania	Iron ore,concntr.not agg (44.2%)	Molluscs (19.8%)	Fish,frozen ex.fillets (18.5%)	3
Mauritius	**Sugars,beet or cane, raw (18.5%)**	**T-shirts,othr.vests knit (13.3%)**	**Jersys,pullovers,etc.knit (11.2%)**	**9**
Morocco	**Trousers,breeches,etc. (10.9%)**	**Molluscs (6.1%)**	**Natural calc.phosphates (4.8%)**	**31**
Mozambique	**Alum.,alum.alloy,unwrght (62.9%)**	**Crustaceans, frozen (10.0%)**		**3**
Namibia	Diamonds.excl.industrial (28.9%)	Fish fillets, frozen (14.1%)	Radio-active chemicals (11.7%)	6
Niger	**Radio-active chemicals (50.6%)**	**Natural gas, liquefied (9.1%)**	**Rice,milled,semi-milled (4.8%)**	**7**
Nigeria	**Crude petroleum (88.9%)**			**1**
Rwanda	**Crude petroleum (55.2%)**	**Coffee, not roasted (18.0%)**	**Ore etc.molybdn.niob.etc (16.5%)**	**3**
São Tomé and Principe	Cocoa beans (65.5%)	Oth.polymers of ethylene (5.0%)	Molluscs (4.9%)	3
Senegal	**Inorganic acid,oxide etc (21.5%)**	**Molluscs (11.4%)**	**Groundnut oil, fractions (8.6%)**	**12**
Seychelles	Fish,prepard,presrvd,nes (54.0%)	Fish,frozen ex.fillets (26.8%)	Fish fillets, frozen (4.9%)	2
Sierra Leone	Diamonds.excl.industrial (27.9%)	Convertible seats, parts (21.3%)	Spirits (5.8%)	13
Somalia	Chem.wood pulp,dissolvng (38.4%)	Sheep and goats, live (19.7%)	Fuel wood, wood charcoal(10.8%)	5
South Africa	**Diamonds.excl.industrial (14.9%)**	**Platinum (10.2%)**	**Pass.transport vehicles (6.0%)**	**60**
Sudan	Crude petroleum (76.2%)	Sheep and goats, live (5.9%)	Sesame (sesamum) seeds (4.1%)	1
Swaziland	Essential oils, perfume, etc (19.6%)	Edible products, preps nes (18.4%)	Sugar and honey (11.4%)	9
Tanzania	**Fish fillets,fresh,chilled (12.1%)**	**Edible nuts fresh,dried (8.3%)**	**Fish fillets, frozen (6.5%)**	**17**
Togo	Natural calc.phosphates (30.8%)	Cotton,not carded,combed (13.1%)	Cocoa beans (8.0%)	10
Tunisia	**Trousers,breeches,etc.(18.5%)**	**Crude petroleum (6.2%)**	**Insulated wire,etc.condctr (6.0%)**	**32**
Uganda	**Coffee, not roasted (34.1%)**	**Fish fillets,fresh,chilled (13.0%)**	**Tobacco,stemmed,stripped (10.4%)**	**7**
Zambia	**Copper;anodes;alloys (36.1%)**	**Copper plate,etc.15mm+th (13.4%)**	**Cobalt,cadmium,etc.unwrt (9.6%)**	**7**
Zimbabwe	Tobacco,stemmed,stripped (35.1%)	Other ferro-alloys (7.2%)	Nickel,nckl.alloy,unwrgt (5.1%)	15
Africa**	**Crude petroleum (35.0%) [15.2%]**	**Diamonds.excl.industrial (4.7%) [11.7%]**	**Platinum (2.4%) [30.4%]**	**47**

Note: * Products are reported when they account for more than 4 per cent of total exports.
** Figures in [ ] represent the share of Africa in World exports for each product.

Source: PC-TAS 1998-2002 International Trade Center UNCTAD/WTO and the UN Statistics Division.

Table 8 - Diversification and Competitiveness

	Diversification index					Annual export growth (%)	Competitiveness Indicator 1998-2002 (%)	
	1998	1999	2000	2001	2002	1998-2002	Sectoral effect	Global competitiveness effect
Algeria	**6.8**	**6.5**	**5.8**	**5.7**	**3.0**	**7.0**	**2.6**	**2.0**
Angola	**1.4**	**1.4**	**1.3**	**1.3**	**1.2**	**25.6**	**14.7**	**8.4**
Benin	**1.9**	**2.7**	**3.2**	**2.1**	**3.6**	**-8.9**	**-11.1**	**-0.3**
Botswana	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Burkina Faso	**2.2**	**2.2**	**4.2**	**4.5**	**8.6**	**-0.9**	**-9.3**	**5.9**
Burundi	1.3	1.9	1.6	2.0	1.7	-17.1	-14.4	-5.2
Cameroon	**7.1**	**7.0**	**5.3**	**4.9**	**4.3**	**-0.6**	**0.4**	**-3.5**
Cape Verde	10.1	6.2	8.5	9.6	5.5	-10.6	-2.9	-10.2
Central African Republic	2.1	1.7	1.8	2.4	2.0	-5.5	1.2	-9.2
Chad	**1.3**	**1.4**	**1.6**	**1.5**	**1.7**	**-12.6**	**-11.0**	**-4.1**
Comoros	2.6	4.6	2.3	1.3	2.4	111.9	2.8	106.6
Congo	**2.2**	**2.2**	**2.0**	**1.8**	**1.5**	**10.0**	**9.5**	**-1.9**
Congo. Dem. Rep.	**2.6**	**2.0**	**2.4**	**2.4**	**1.8**	**5.2**	**0.7**	**2.0**
Côte d'Ivoire	**5.3**	**5.2**	**6.7**	**6.0**	**4.7**	**-3.7**	**-4.4**	**-1.8**
Djibouti	16.3	14.4	25.8	26.7	17.6	62.6	-4.0	64.2
Egypt	**9.9**	**8.9**	**14.9**	**26.2**	**24.9**	**3.0**	**2.4**	**-1.8**
Equatorial Guinea	1.9	1.9	1.5	1.3	1.2	79.1	9.1	67.5
Eritrea	4.3	4.5	13.1	15.3	17.5	-16.4	-5.0	-13.8
Ethiopia	**1.9**	**2.5**	**2.5**	**5.4**	**5.1**	**-6.3**	**-12.3**	**3.5**
Gabon	**1.9**	**1.8**	**1.6**	**1.7**	**1.7**	**5.0**	**10.3**	**-7.8**
Gambia	1.8	2.4	3.5	5.6	7.8	-19.0	3.5	-25.0
Ghana	**7.3**	**7.6**	**8.1**	**7.9**	**5.6**	**-3.7**	**-2.7**	**-3.4**
Guinea	3.2	3.5	3.5	3.4	3.8	0.8	-3.6	2.0
Guinea Bissau	4.0	2.7	2.4	1.5	1.6	-1.9	2.0	-6.4
Kenya	**10.3**	**11.2**	**11.8**	**11.7**	**10.8**	**-1.1**	**-4.9**	**1.4**
Lesotho	...	...	...	...	...	...	...	...
Liberia	2.0	3.1	2.9	2.2	2.1	-10.6	0.7	-13.7
Libya	1.5	1.6	1.5	1.5	1.2	8.9	13.7	-7.3
Madagascar	**16.6**	**16.8**	**11.3**	**9.1**	**8.3**	**2.3**	**-3.5**	**-3.3**
Malawi	2.8	2.6	2.4	2.7	2.8	-2.0	-3.0	-1.5
Mali	**1.3**	**1.4**	**1.9**	**3.3**	**2.7**	**-11.4**	**-10.7**	**-6.1**

Table 8 - **Diversification and Competitiveness** *(cont.)*

	Diversification index					Annual export growth (%)	Competitiveness Indicator 1998-2002 (%)	
	1998	1999	2000	2001	2002	1998-2002	Sectoral effect	Global competitiveness effect
Mauritania	3.4	3.5	3.6	3.5	3.7	-1.4	0.2	-4.0
Mauritius	**10.2**	**11.2**	**12.6**	**11.8**	**11.8**	**-1.2**	**-3.1**	**-0.6**
Morocco	**33.7**	**32.9**	**36.0**	**35.8**	**36.9**	**1.9**	**-3.3**	**2.7**
Mozambique	**8.1**	**8.5**	**9.2**	**2.9**	**2.4**	**54.7**	**-2.4**	**54.7**
Namibia	...	...	...	...	...	...	...	...
Niger	**2.2**	**2.4**	**2.1**	**5.0**	**3.7**	**-14.5**	**7.3**	**-24.3**
Nigeria	**1.3**	**1.3**	**1.2**	**1.3**	**1.3**	**9.6**	**14.5**	**-7.3**
Rwanda	**3.1**	**2.6**	**3.1**	**2.6**	**2.7**	**5.7**	**-13.5**	**16.7**
SACU*	**25.3**	**27.6**	**28.3**	**28.6**	**24.4**	**8.1**	**-1.8**	**7.5**
São Tomé and Principe	3.0	5.4	3.8	7.2	2.3	-10.4	-2.0	-10.9
Senegal	**16.0**	**14.0**	**16.7**	**11.9**	**11.9**	**3.0**	**-3.9**	**4.4**
Seychelles	2.1	2.0	1.9	2.6	2.7	51.8	-0.4	49.8
Sierra Leone	2.3	4.4	4.1	6.9	7.5	5.9	3.7	-0.3
Somalia	4.4	3.6	2.9	10.9	4.9	-4.0	2.8	-9.3
South Africa	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Sudan	9.5	6.4	2.0	1.6	1.7	62.4	-4.7	64.6
Swaziland	...	...	...	...	...	...	...	...
Tanzania	**12.8**	**13.7**	**17.5**	**19.4**	**20.5**	**-1.1**	**-5.9**	**2.4**
Togo	5.0	7.2	7.7	8.5	7.7	-9.5	-8.1	-3.8
Tunisia	**25.9**	**26.7**	**28.7**	**28.1**	**28.9**	**3.3**	**-2.0**	**2.8**
Uganda	**1.9**	**2.0**	**3.1**	**6.0**	**6.4**	**-5.1**	**-11.7**	**4.1**
Zambia	**4.5**	**6.1**	**5.0**	**4.7**	**5.9**	**-6.2**	**-4.7**	**-3.9**
Zimbabwe	13.7	9.9	11.7	9.6	7.1	-4.2	-3.1	-3.5
Africa	**14.1**	**11.1**	**7.0**	**8.7**	**7.7**	**6.1**	**2.4**	**1.3**

Note: * Includes Botswana, Lesotho, Namibia, South Africa and Swaziland.
Sources: PC-TAS 1998-2002 International Trade Center UNCTAD/WTO and the UN Statistics Division.

Table 9 - **International Prices of Exports, 1998-2004**

	Unit	1998	1999	2000	2001	2002	2003	2004
Aluminum	($/mt)	1357.47	1361.09	1549.14	1443.63	1349.92	1431.29	1715.54
Banana (US)	($/mt)	489.51	373.21	424.00	583.25	528.58	374.79	524.58
Coal (US)	($/mt)	34.50	33.32	33.06	44.86	40.02	...	...
Cocoa	(cents/kg)	167.64	113.53	90.58	106.90	177.79	175.09	154.98
Coffee (Arabica)	(cents/kg)	298.13	229.06	191.97	137.31	135.66	141.54	177.40
Coffee (Robusta)	(cents/kg)	182.26	148.88	91.30	60.72	66.18	81.45	79.31
Copper	($/mt)	1654.06	1572.86	1813.47	1578.29	1559.48	1779.15	2865.88
Cotton	(c/kg)	144.47	117.11	130.22	105.81	101.92	139.91	136.57
Fish Meal	($/mt)	664.10	394.27	429.48	486.70	605.92	610.71	648.58
Gold	($/toz)	295.13	280.02	279.03	271.00	310.00	363.51	409.20
Groundnut oil	($/mt)	909.42	787.67	713.67	680.25	687.08	1243.17	1159.50
Iron ore	(c/dmtu)	31.00	27.59	28.79	30.03	29.31	31.95	37.90
Lead	(c/kg)	53.04	50.49	45.39	47.60	45.30	51.50	88.70

Table 9 - International Prices of Exports, 1998-2004 *(cont.)*

	Unit	1998	1999	2000	2001	2002	2003	2004
Logs (Cameroon)	($/CM)	286.40	269.27	275.43	266.10	...	...	...
Maize	($/mt)	101.99	90.22	88.53	89.60	99.27	105.37	111.80
Oil (crude)	($/bbl)	13.07	18.07	28.23	24.35	24.97	28.85	38.30
Palm oil	($/mt)	671.08	436.00	310.25	285.70	390.25	443.25	471.33
Phosphate (rock)	($/mt)	43.00	44.00	43.75	41.80	40.38	38.00	40.98
Rubber (Malaysia)	(cents/kg)	72.16	62.85	66.72	57.51	76.49	108.27	130.40
Sugar (EEC)	(cents/kg)	59.94	59.44	57.71	52.86	54.92	59.72	66.97
Sugar (free market)	(c/kg)	19.67	13.81	18.04	19.04	15.18	15.63	15.80
Sugar (US)	(cents/kg)	48.80	46.81	44.45	47.04	46.14	47.37	45.47
Tea (Avg. 3 auctions)	(c/kg)	204.61	183.89	187.62	159.80	150.60	151.66	168.51
Tea (Mombasa)	(c/kg)	189.91	179.83	202.86	151.70	149.21	154.36	155.42
Tobacco	($/mt)	3336.12	3041.58	2976.21	3011.00	2744.50	2646.10	2765.00

Source: World Bank, *Global Commodity Price Prospects*, January 2005.

Table 10 - Foreign Direct Investment, 1998-2003 ($ million)

	FDI inflows								FDI outflows								FDI inflows / GFCF							
	1996	1997	1998	1999	2000	2001	2002	2003	1996	1997	1998	1999	2000	2001	2002	2003	1996	1997	1998	1999	2000	2001	2002	2003
Algeria	**270**	**260**	**501**	**507**	**438**	**1196**	**1065**	**634**	**2**	**8**	**1**	**47**	**18**	**9**	**100**	**14**	**2.3**	**2.4**	**4.0**	**4.3**	**3.8**	**9.6**	**7.7**	**4.0**
Angola	**181**	**412**	**1114**	**2471**	**879**	**2146**	**1643**	**1415**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**8.0**	**21.1**	**48.6**	**148.0**	**65.6**	**179.1**	**114.8**	**80.0**
Benin	**13**	**14**	**33**	**38**	**56**	**41**	**41**	**51**	**12**	**12**	**2**	**23**	**8**	**2**	**0**	**3**	**3.7**	**3.5**	**8.2**	**9.0**	**13.0**	**9.1**	**8.5**	**8.1**
Botswana	**72**	**100**	**96**	**37**	**57**	**31**	**405**	**86**	**- 1**	**4**	**4**	**1**	**2**	**381**	**43**	**40**	**6.0**	**7.7**	**7.0**	**2.6**	**4.3**	**2.4**	**33.0**	**5.1**
Burkina Faso	**16**	**10**	**4**	**8**	**23**	**8**	**9**	**11**	**1**	**1**	**5**	**5**	**0**	**1**	**1**	**1**	**2.9**	**1.7**	**0.7**	**1.4**	**4.6**	**1.5**	**1.5**	**1.5**
Burundi	0	0	2	0	12	0	0	0	0	0	0	1	0	0	0	0	...	...	2.7	0.3	19.6	0.0	0.0	0.0
Cameroon	**35**	**45**	**50**	**40**	**31**	**75**	**176**	**215**	**13**	**7**	**1**	**3**	**4**	**3**	**3**	**3**	**2.5**	**3.1**	**3.3**	**2.3**	**2.2**	**5.0**	**9.8**	**10.1**
Cape Verde	29	12	9	53	34	9	12	14	0	0	0	0	1	1	0	1	26.0	8.9	8.2	45.8	31.5	8.7	8.8	9.1
Central African Republic	11	1	8	4	1	5	6	4	1	0	0	0	0	0	1	0	18.0	2.1	7.0	2.9	1.0	6.3	6.7	5.1
Chad	**39**	**43**	**22**	**25**	**116**	**453**	**1 030**	**837**	**1**	**1**	**0**	**- 2**	**0**	**0**	**0**	**0**	**16.0**	**17.1**	**9.2**	**11.9**	**37.4**	**66.9**	**82.3**	**58.4**
Comoros	1	0	0	0	0	1	0	1	0	0	0	0	0	0	0	0	2.8	0.1	1.5	1.4	0.6	5.7	1.7	3.2
Congo	**71**	**77**	**34**	**491**	**168**	**76**	**152**	**386**	**0**	**3**	**- 9**	**2**	**4**	**6**	**7**	**- 1**	**8.8**	**15.4**	**7.2**	**78.4**	**27.0**	**10.4**	**22.5**	**48.6**
Congo. Dem. Rep.	**25**	**-44**	**61**	**11**	**23**	**82**	**117**	**158**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**1.3**	**-1.9**	**6.2**	**1.1**	**15.5**	**30.6**	**23.6**	**22.7**
Côte d'Ivoire	**269**	**415**	**380**	**324**	**235**	**273**	**230**	**389**	**33**	**34**	**36**	**57**	**0**	**2**	**2**	**2**	**15.0**	**24.4**	**18.6**	**17.8**	**20.1**	**26.1**	**17.5**	**30.4**
Djibouti	3	2	3	4	3	3	4	11	0	0	0	0	0	0	0	0	7.4	5.1	6.8	9.0	4.9	7.2	5.4	11.7
Egypt	**636**	**887**	**1076**	**1065**	**1235**	**510**	**647**	**237**	**5**	**166**	**46**	**38**	**51**	**12**	**28**	**21**	**5.8**	**6.3**	**7.0**	**5.7**	**6.6**	**3.0**	**4.2**	**1.9**
Equatorial Guinea	242	52	306	238	109	931	323	1 431	0	0	0	2	- 4	4	0	0	78.4	11.7	54.4	50.5	19.6	95.3	51.7	187.8
Eritrea	37	41	149	83	28	12	20	22	0	0	0	0	0	0	0	0	19.2	19.1	74.6	32.5	22.7	6.3	11.9	16.7
Ethiopia	**22**	**288**	**261**	**70**	**135**	**20**	**75**	**60**	**0**	**228**	**254**	**- 46**	**- 1**	**69**	**7**	**25**	**2.2**	**26.6**	**23.4**	**6.4**	**13.0**	**1.7**	**6.0**	**4.4**
Gabon	**-487**	**-310**	**104**	**- 205**	**- 43**	**- 88**	**251**	**53**	**- 7**	**13**	**- 15**	**12**	**26**	**4**	**0**	**0**	**-46.1**	**-18.9**	**6.1**	**-18.4**	**-3.9**	**-7.2**	**20.7**	**3.7**
Gambia	18	21	24	49	44	35	43	60	5	5	6	4	5	5	5	7	20.6	25.2	30.0	62.6	58.9	48.9	53.5	85.2
Ghana	**120**	**82**	**56**	**267**	**115**	**89**	**59**	**137**	**150**	**50**	**30**	**77**	**52**	**53**	**61**	**55**	**8.5**	**5.0**	**3.3**	**16.5**	**9.5**	**6.4**	**5.0**	**7.7**
Guinea	24	17	18	63	10	2	30	8	1	1	1	3	2	2	2	2	2.9	2.1	2.5	8.7	1.5	0.4	7.2	2.2
Guinea Bissau	1	11	4	9	1	1	1	2	0	0	0	0	0	0	0	0	2.0	17.2	18.8	22.8	2.9	2.4	5.6	7.8
Kenya	**11**	**53**	**11**	**14**	**111**	**5**	**28**	**82**	**- 3**	**0**	**0**	**0**	**0**	**0**	**7**	**2**	**0.6**	**2.8**	**0.6**	**0.9**	**7.3**	**0.3**	**1.7**	**4.6**
Lesotho	28	32	27	33	31	28	27	42	0	0	0	0	0	0	0	0	5.2	5.9	6.3	7.6	8.5	9.2	8.8	9.8
Liberia	-132	214	190	27	21	8	3	0	- 59	501	- 731	310	608	- 167	- 50	130	...	...	...	...	...	...	...	...
Libya	-112	-68	- 128	- 128	- 142	- 101	- 96	700	63	284	299	208	98	84	110	100	...	...	-4.3	-3.9	-3.3	-2.8	-3.6	27.4
Madagascar	**10**	**14**	**16**	**58**	**69**	**84**	**8**	**50**	**- 1**	**- 2**	**1**	**0**	**1**	**0**	**0**	**0**	**2.1**	**3.0**	**2.9**	**10.5**	**5.8**	**6.3**	**1.1**	**4.3**
Malawi	16	15	12	59	26	19	6	23	2	1	6	3	3	4	3	3	7.1	6.0	6.3	25.2	12.1	10.1	3.6	14.9
Mali	**43**	**70**	**9**	**1**	**78**	**104**	**102**	**129**	**4**	**5**	**27**	**50**	**4**	**17**	**19**	**13**	**6.9**	**11.7**	**1.4**	**0.3**	**13.0**	**16.7**	**16.3**	**14.1**

Table 10 - **Foreign Direct Investment, 1998-2003** ($ million) *(cont.)*

	FDI inflows								FDI outflows								FDI inflows / GFCF							
	1996	1997	1998	1999	2000	2001	2002	2003	1996	1997	1998	1999	2000	2001	2002	2003	1996	1997	1998	1999	2000	2001	2002	2003
Mauritania	4	1	0	1	40	92	118	214	0	0	0	0	0	0	0	0	2.5	0.4	0.1	0.5	18.8	43.2	53.2	79.2
Mauritius	**37**	**55**	**12**	**49**	**277**	**32**	**33**	**70**	**3**	**3**	**14**	**6**	**13**	**3**	**9**	**41**	**3.5**	**4.6**	**1.2**	**4.6**	**24.2**	**3.0**	**3.1**	**5.7**
Morocco	**322**	**1188**	**417**	**850**	**215**	**2825**	**481**	**2279**	**28**	**9**	**20**	**18**	**58**	**97**	**28**	**12**	**4.5**	**17.2**	**5.3**	**10.2**	**2.7**	**37.4**	**5.8**	**22.2**
Mozambique	**73**	**64**	**235**	**382**	**139**	**255**	**155**	**337**	**1**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**12.0**	**9.7**	**24.5**	**25.4**	**10.5**	**17.9**	**14.3**	**27.4**
Namibia	129	84	77	20	186	365	181	84	- 22	1	- 1	- 1	3	- 13	- 5	- 6	15.6	11.7	9.9	2.5	29.0	51.7	32.4	8.9
Niger	**2**	**17**	**- 1**	**0**	**9**	**26**	**8**	**31**	**18**	**8**	**10**	**0**	**- 1**	**- 4**	**0**	**- 1**	**1.3**	**8.5**	**-0.5**	**0.2**	**4.5**	**11.4**	**2.6**	**8.2**
Nigeria	**1593**	**1539**	**1051**	**1005**	**930**	**1104**	**1281**	**1200**	**42**	**58**	**107**	**92**	**85**	**94**	**101**	**93**	**31.8**	**25.4**	**12.2**	**9.7**	**9.9**	**10.2**	**10.7**	**9.2**
Rwanda	**2**	**3**	**7**	**2**	**8**	**4**	**7**	**5**	**1**	**1**	**0**	**1**	**1**	**1**	**1**	**1**	**1.1**	**1.0**	**2.4**	**0.5**	**2.6**	**1.2**	**2.5**	**1.5**
São Tomé and Principe	0	0	4	3	4	3	3	10	0	0	0	0	0	0	0	0	1.3	0.6	28.9	16.2	22.9	20.3	17.3	55.3
Senegal	**5**	**177**	**60**	**142**	**62**	**39**	**54**	**78**	**2**	**1**	**10**	**6**	**1**	**- 7**	**39**	**11**	**0.5**	**18.8**	**5.4**	**13.4**	**5.9**	**3.7**	**4.7**	**5.2**
Seychelles	30	54	55	60	56	65	48	58	13	10	3	9	7	9	9	8	14.9	34.5	26.6	31.3	30.2	30.7	24.2	43.3
Sierra Leone	19	10	- 10	6	5	2	4	8	0	0	0	0	0	0	0	0	18.3	46.6	-27.5	17.2	9.7	4.5	4.4	4.7
Somalia	1	1	0	- 1	0	0	0	1	0	0	0	0	0	0	0	0	0.6	0.5	0.0	-0.4	0.1	0.0	0.0	0.3
South Africa	**818**	**3817**	**561**	**1502**	**888**	**6789**	**757**	**762**	**1044**	**2351**	**1779**	**1580**	**271**	**-3180**	**- 399**	**720**	**3.5**	**15.5**	**2.5**	**7.5**	**4.7**	**40.8**	**4.7**	**3.0**
Sudan	0	98	371	371	392	574	713	1 349	0	0	0	0	0	0	0	0	...	...	26.0	31.4	25.7	34.5	36.0	59.2
Swaziland	22	-15	109	100	91	51	47	44	- 11	- 10	23	12	17	- 18	- 9	- 1	8.3	-5.3	35.8	38.8	30.5	17.6	22.3	12.4
Tanzania	**149**	**158**	**172**	**542**	**282**	**467**	**240**	**248**	**0**	**0**	**0**	**0**	**1**	**0**	**0**	**0**	**14.0**	**14.1**	**12.8**	**40.8**	**17.8**	**29.4**	**12.9**	**13.1**
Togo	14	19	19	29	41	71	53	20	13	4	22	41	1	- 7	0	- 2	7.2	10.5	7.5	13.6	21.6	37.7	28.7	7.9
Tunisia	**280**	**365**	**668**	**368**	**779**	**486**	**821**	**584**	**2**	**9**	**2**	**3**	**2**	**0**	**1**	**1**	**6.2**	**7.8**	**13.5**	**7.0**	**15.2**	**9.3**	**15.5**	**10.0**
Uganda	**122**	**177**	**210**	**222**	**275**	**229**	**249**	**283**	**11**	**15**	**20**	**- 8**	**- 28**	**- 5**	**- 14**	**- 15**	**11.8**	**16.7**	**20.0**	**19.2**	**23.6**	**22.2**	**22.0**	**22.2**
Zambia	**117**	**207**	**198**	**163**	**122**	**72**	**82**	**100**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**31.8**	**40.6**	**41.3**	**32.5**	**21.8**	**10.5**	**10.0**	**9.4**
Zimbabwe	81	135	444	59	23	4	26	20	51	28	9	9	8	4	3	5	5.2	8.8	34.0	7.3	34.3	1.8	5.7	12.3
Africa	**5331**	**10919**	**9114**	**11590**	**8728**	**19616**	**11780**	**15033**	**1418**	**3812**	**1982**	**2564**	**1319**	**-2535**	**115**	**1288**	**5.5**	**10.6**	**8.6**	**10.8**	**8.4**	**19.2**	**11.4**	**12.4**

Source: UNCTAD, FDI Online Database.

Table 11 - Aid Flows, 1998-2003 ($ million)

	ODA net total, All donors						ODA net total, DAC countries						ODA net total, Multilateral					
	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003
Algeria	**421**	**138**	**201**	**224**	**329**	**232**	**148**	**86**	**66**	**63**	**123**	**169**	**253**	**21**	**64**	**107**	**63**	**68**
Angola	**335**	**388**	**307**	**289**	**421**	**499**	**214**	**252**	**189**	**179**	**286**	**372**	**121**	**136**	**112**	**110**	**136**	**126**
Benin	**205**	**211**	**239**	**274**	**216**	**294**	**144**	**119**	**191**	**144**	**140**	**196**	**63**	**93**	**49**	**128**	**74**	**97**
Botswana	**106**	**61**	**31**	**29**	**38**	**30**	**73**	**41**	**24**	**24**	**37**	**27**	**36**	**21**	**8**	**4**	**3**	**3**
Burkina Faso	**400**	**398**	**336**	**392**	**473**	**451**	**227**	**232**	**228**	**221**	**230**	**266**	**167**	**157**	**104**	**158**	**198**	**185**
Burundi	67	74	93	137	172	224	44	52	41	55	85	121	24	22	52	83	87	103
Cameroon	**499**	**435**	**380**	**487**	**609**	**884**	**303**	**254**	**213**	**357**	**436**	**756**	**198**	**184**	**169**	**132**	**172**	**128**
Cape Verde	130	137	94	77	92	144	85	89	70	49	43	90	45	48	25	29	50	53
Central African Republic	120	118	75	67	60	50	57	59	53	48	40	32	63	59	22	19	20	17
Chad	**168**	**188**	**131**	**187**	**229**	**247**	**75**	**64**	**53**	**73**	**67**	**96**	**88**	**116**	**77**	**114**	**160**	**151**
Comoros	35	21	19	27	32	24	19	13	11	10	11	11	16	8	8	16	17	13
Congo	**66**	**142**	**33**	**75**	**57**	**70**	**60**	**121**	**23**	**30**	**41**	**34**	**6**	**20**	**10**	**46**	**16**	**36**
Congo, Dem. Rep.	**125**	**132**	**184**	**263**	**1169**	**5381**	**80**	**87**	**103**	**143**	**351**	**5009**	**43**	**45**	**81**	**119**	**818**	**371**
Côte d'Ivoire	**967**	**448**	**352**	**170**	**1069**	**252**	**490**	**366**	**250**	**159**	**831**	**281**	**477**	**81**	**101**	**11**	**237**	**-29**
Djibouti	81	75	71	58	78	78	62	55	42	28	37	37	17	19	20	30	39	38
Egypt	**1955**	**1582**	**1328**	**1257**	**1239**	**894**	**1472**	**1298**	**1139**	**1090**	**1124**	**775**	**268**	**211**	**136**	**105**	**84**	**86**
Equatorial Guinea	22	20	21	13	20	21	18	15	18	13	14	18	4	6	3	1	7	4
Eritrea	167	149	176	281	230	307	98	80	112	151	121	185	38	50	55	127	97	122
Ethiopia	**660**	**643**	**693**	**1116**	**1307**	**1504**	**365**	**325**	**379**	**367**	**489**	**1033**	**282**	**303**	**298**	**721**	**784**	**440**
Gabon	**45**	**48**	**12**	**9**	**72**	**-11**	**37**	**34**	**-12**	**-8**	**49**	**-41**	**9**	**13**	**23**	**17**	**22**	**30**
Gambia	39	34	49	54	61	60	13	13	15	13	18	20	25	19	32	38	40	40
Ghana	**702**	**609**	**600**	**644**	**650**	**907**	**375**	**356**	**376**	**387**	**406**	**479**	**325**	**250**	**222**	**254**	**238**	**415**
Guinea	359	238	153	282	250	238	148	111	93	122	126	135	187	109	58	160	118	103
Guinea Bissau	96	52	80	59	59	145	65	32	42	30	26	98	31	20	39	29	34	48
Kenya	**415**	**310**	**512**	**463**	**394**	**483**	**276**	**254**	**293**	**270**	**288**	**320**	**138**	**53**	**214**	**188**	**95**	**163**
Lesotho	61	31	37	56	76	79	33	26	22	29	30	33	30	7	16	28	48	46
Liberia	72	94	68	39	52	107	31	45	24	16	27	70	41	49	44	24	26	37
Libya	7	7	15	10	10	10	4	3	12	4	4	5	3	4	3	5	5	5
Madagascar	**481**	**359**	**322**	**374**	**373**	**539**	**334**	**192**	**139**	**146**	**126**	**224**	**148**	**166**	**185**	**229**	**248**	**314**
Malawi	435	447	446	404	377	498	204	228	269	196	225	314	230	214	171	198	142	182
Mali	**347**	**355**	**360**	**354**	**467**	**528**	**236**	**237**	**300**	**209**	**257**	**272**	**117**	**117**	**61**	**132**	**156**	**257**

Table 11 - Aid Flows, 1998-2003 ($ million) *(cont.)*

	ODA net total, All donors						ODA net total, DAC countries						ODA net total, Multilateral					
	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003	1998	1999	2000	2001	2002	2003
Mauritania	165	219	212	268	345	243	64	89	82	81	147	136	108	125	129	188	200	106
Mauritius	42	42	20	22	24	-15	20	5	12	8	4	-18	23	37	7	6	20	3
Morocco	530	679	419	519	487	523	251	333	293	342	217	336	249	316	130	142	136	156
Mozambique	1040	805	877	933	2054	1033	713	593	624	720	1661	697	330	213	253	208	391	335
Namibia	181	179	153	110	135	146	129	117	97	77	85	110	51	60	55	31	48	34
Niger	292	187	211	257	298	453	145	120	106	114	114	245	146	66	105	142	181	209
Nigeria	204	152	185	185	314	318	34	53	84	108	215	200	170	96	100	79	101	118
Rwanda	350	373	322	299	355	332	209	181	175	149	199	213	141	193	146	150	156	118
São Tomé and Principe	28	28	35	38	26	38	18	19	18	22	19	25	10	8	17	16	7	12
Senegal	501	535	423	413	445	450	289	416	288	224	243	314	211	115	140	189	192	135
Seychelles	24	13	18	14	8	9	17	5	3	8	4	5	6	6	8	5	4	3
Sierra Leone	106	74	182	345	353	297	53	60	116	167	225	208	51	13	67	176	125	89
Somalia	80	115	104	150	194	175	42	76	56	88	102	114	38	39	47	47	47	62
South Africa	514	541	488	428	505	625	421	386	354	313	375	477	92	153	132	114	129	147
Sudan	209	243	225	185	351	621	150	159	90	108	232	332	59	58	36	68	68	282
Swaziland	35	29	13	29	22	27	17	15	3	4	7	13	14	14	10	22	12	14
Tanzania	1000	990	1022	1271	1233	1669	769	613	779	944	903	966	228	376	246	333	333	703
Togo	128	71	70	44	51	45	66	47	52	28	39	46	61	21	16	12	9	-2
Tunisia	150	253	223	378	265	306	102	102	150	184	145	208	78	161	72	193	78	95
Uganda	647	590	819	793	638	959	384	357	578	386	466	587	263	232	236	405	167	371
Zambia	349	624	795	349	641	560	257	340	486	274	360	592	93	283	309	74	279	-32
Zimbabwe	261	245	178	164	201	186	216	219	193	149	178	161	46	25	-14	19	22	25
Africa Unspecified	1281	1145	1320	1331	1635	2150	1092	893	970	1045	1341	1759	189	249	337	271	256	390
Africa Total	17708	16074	15733	16693	21260	26319	11246	10340	10385	10163	13367	19163	6150	5484	5048	6248	7195	7025

Note: ODA: Overseas development assistance.
DAC: OECD Development Assistance Committee.
Source: OECD Development Assistance Committee.

Table 12 - External Debt Indicators

Country	Stock of total external debt ($ million, current prices) 1998	1999	2000	2001	2002	2003	Stock of total external debt / GNP (%) 1998	2003	Long-term debt /total debt (%) 2003	Distribution of long-term debt (%) 2003 Multilateral	Bilateral	Private	Total debt service paid / exports of goods and services (%) 1998	2003
Algeria	30 678	27 997	25 272	22 586	22 876	23 386	67.6	36.2	95.2	18.5	57.1	24.5	...	...
Angola	10 786	10 301	9 410	9 236	9 247	9 698	206.2	90.4	88.4	4.1	32.5	63.5	41.4	14.9
Benin	1 651	1 687	1 591	1 661	1 836	1 828	71.1	53.0	94.4	74.9	24.8	0.2	9.1	6.6
Botswana	532	504	453	400	488	514	10.5	7.1	94.4	68.7	28.2	3.1	2.6	1.3
Burkina Faso	1 495	1 622	1 457	1 540	1 630	1 845	53.6	44.1	89.5	88.4	11.5	0.0	...	11.2
Burundi	1 119	1 131	1 103	1 070	1 204	1 310	128.7	227.7	94.2	86.1	12.9	0.9	41.9	65.8
Cameroon	9 966	9 485	9 299	8 401	8 555	9 189	121.0	78.2	92.5	18.5	73.2	8.2	...	...
Cape Verde	247	327	327	361	414	480	46.2	61.2	90.5	74.5	19.8	5.6	10.1	5.7
Central African Republic	919	909	858	822	1 065	1 328	89.3	111.2	69.1	72.5	23.7	3.7	...	...
Chad	1 096	1 145	1 119	1 108	1 285	1 499	63.5	63.4	91.4	89.3	9.7	1.0	...	...
Comoros	227	228	232	243	270	288	105.5	89.0	90.3	80.0	20.0	0.0	...	...
Congo	5 119	5 033	4 887	4 491	5 153	5 516	346.0	205.7	80.2	14.1	67.0	18.9	2.8	4.0
Congo. Dem. Rep.	13 203	12 048	11 692	11 519	10 060	11 171	227.1	207.4	90.2	27.7	68.6	3.7	...	...
Côte d'Ivoire	14 852	13 170	12 138	11 618	11 791	12 187	123.6	93.8	89.0	30.3	37.4	32.3	25.7	8.5
Djibouti	288	275	262	263	335	396	54.8	61.8	92.5	66.8	31.7	1.5	...	...
Egypt	32 440	31 045	29 187	29 333	30 001	31 383	38.9	38.2	87.9	14.9	80.7	4.4	10.6	11.7
Equatorial Guinea	306	271	248	239	260	319	75.6	...	71.3	46.9	46.1	7.1	...	...
Eritrea	151	253	311	414	520	635	17.3	75.5	95.4	68.3	31.7	0.0	3.1	14.1
Ethiopia	10 347	5 544	5 483	5 727	6 515	7 151	160.4	108.4	96.6	63.6	35.4	1.0	11.9	6.8
Gabon	4 427	3 982	3 920	3 423	3 546	3 792	108.8	72.9	89.5	11.9	80.5	7.6	14.0	...
Gambia	460	465	483	487	573	629	115.9	170.1	89.2	80.3	19.5	0.2	...	...
Ghana	6 933	6 979	6 625	6 735	7 340	7 957	94.7	106.7	85.5	68.5	24.0	7.5	22.4	14.7
Guinea	3 546	3 522	3 388	3 254	3 401	3 457	102.5	96.1	91.2	59.4	39.7	0.9	19.5	15.1
Guinea-Bissau	966	934	804	668	699	745	502.0	326.6	95.6	61.2	38.8	0.0	...	16.2
Kenya	6 824	6 473	6 181	5 573	6 112	6 766	60.0	47.5	84.7	56.7	35.4	7.8	22.9	15.8
Lesotho	688	682	672	598	658	707	60.3	51.2	95.7	78.2	11.4	10.4	8.5	8.8
Liberia	2 103	2 077	2 032	2 164	2 324	2 568	655.3	679.2	43.9	38.6	43.3	18.1	...	...
Libya	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Madagascar	4 394	4 755	4 701	4 160	4 518	4 958	119.9	91.9	93.2	54.0	43.7	2.4	14.7	6.1
Malawi	2 444	2 751	2 716	2 604	2 913	3 134	144.2	187.7	94.4	85.4	14.3	0.4	14.4	7.7
Mali	3 205	3 196	2 980	2 917	2 834	3 129	125.9	75.3	93.0	71.2	28.8	0.0	11.0	...

Table 12 - **External Debt Indicators** *(cont.)*

Country	Stock of total external debt ($ million, current prices) 1998	1999	2000	2001	2002	2003	Stock of total external debt / GNP (%) 1998	2003	Long-term debt /total debt (%) 2003	Distribution of long-term debt (%) 2003 Multilateral	Bilateral	Private	Total debt service paid / exports of goods and services (%) 1998	2003
Mauritania	2 391	2 532	2 489	2 291	2 269	2 360	248.4	203.6	88.3	63.1	36.6	0.4	27.7	...
Mauritius	1 856	1 847	1 720	1 723	1 808	2 550	45.1	48.8	39.2	28.2	33.5	38.3	9.2	7.2
Morocco	23 739	23 015	20 753	19 196	18 395	18 795	68.3	43.7	93.3	33.2	33.9	32.9	23.8	23.5
Mozambique	8 289	6 977	7 046	4 564	4 766	4 930	226.3	120.0	88.9	41.5	26.8	31.8	18.0	6.9
Namibia	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Niger	1 650	1 668	1 686	1 590	1 798	2 117	80.4	77.9	91.9	73.8	23.9	2.3	...	...
Nigeria	30 295	29 128	31 355	31 042	30 476	34 963	103.3	70.0	90.3	9.5	83.0	7.6	11.3	...
Rwanda	1 228	1 294	1 273	1 285	1 437	1 540	61.9	92.7	92.1	89.5	10.4	0.1	17.2	14.4
São Tomé and Principe	257	320	315	313	333	338	717.4	671.7	96.6	61.3	38.7	0.0	32.2	31.0
Senegal	4 070	3 944	3 607	3 665	4 121	4 419	88.5	69.0	91.0	64.2	34.2	1.6	20.7	10.4
Seychelles	245	254	395	502	535	548	41.7	80.8	80.1	16.3	40.6	43.1	5.9	14.0
Sierra Leone	1 314	1 298	1 229	1 295	1 448	1 612	200.7	211.2	88.1	57.8	41.3	0.9	32.9	12.5
Somalia	2 635	2 606	2 562	2 563	2 689	2 838	...	...	68.2	39.8	58.3	1.9	...	...
South Africa	24 753	23 907	24 861	24 050	25 041	27 807	19.0	17.8	73.5	1.0	0.0	99.0	12.1	9.0
Sudan	16 843	16 132	15 741	15 414	16 389	17 496	161.5	106.9	57.5	20.9	57.0	22.1	4.7	0.9
Swaziland	275	301	296	304	342	400	20.3	21.1	86.6	54.1	34.2	11.7	2.4	1.6
Tanzania	7 670	8 081	7 184	6 768	7 339	7 516	92.7	73.4	83.1	68.2	30.0	1.8	21.0	5.2
Togo	1 472	1 521	1 432	1 406	1 587	1 707	96.3	100.5	87.2	61.0	39.0	0.0	7.6	1.9
Tunisia	10 845	11 868	10 612	10 871	12 923	15 502	57.2	64.8	94.8	36.3	21.0	42.7	15.4	43.0
Uganda	3 917	3 498	3 497	3 731	3 991	4 553	60.0	73.8	91.6	90.7	8.9	0.4	20.8	7.1
Zambia	6 879	5 868	5 731	5 671	5 978	6 425	227.6	153.4	84.7	56.3	35.8	7.8	21.0	27.8
Zimbabwe	4 581	4 310	3 816	3 579	3 875	4 445	85.7	...	77.1	45.0	41.4	13.5	...	...

Sources: Global Development Finance Online, World Bank.

Table 13 - Demographic Indicators

	Total population (thousands) 2004	Urban population (% of total) 2004	Sex ratio (males per 100 females) 2004	Population growth rate (%) 1995-2000	Population growth rate (%) 2000-2005	Infant mortality rate (per 1000) 2004	Total fertility rate 2004	Mortality under age 5 (per 1000) 2004	Distribution by age (%) 2004 0-14	Distribution by age (%) 2004 15-64	Distribution by age (%) 2004 65+
Algeria	**32 339**	**66.7**	**102.1**	**1.7**	**1.7**	**41.2**	**2.7**	**45**	**32.0**	**64.9**	**3.1**
Angola	**14 078**	**38.3**	**97.4**	**2.7**	**3.1**	**136.2**	**7.1**	**240**	**47.9**	**51.3**	**0.9**
Benin	**6 918**	**44.5**	**96.8**	**2.7**	**2.6**	**89.4**	**5.5**	**150**	**45.0**	**53.9**	**1.1**
Botswana	**1 795**	**49.7**	**96.6**	**2.2**	**1.0**	**54.4**	**3.5**	**102**	**39.3**	**57.5**	**3.1**
Burkina Faso	**13 393**	**20.7**	**96.0**	**2.9**	**2.9**	**89.7**	**6.6**	**154**	**48.9**	**50.2**	**0.9**
Burundi	7 068	10.8	95.8	0.8	2.8	103.9	6.7	181	45.7	53.9	0.4
Cameroon	**16 296**	**53.3**	**98.6**	**2.4**	**1.9**	**84.9**	**4.4**	**144**	**41.7**	**55.4**	**2.9**
Cape Verde	473	66.2	91.9	2.2	2.0	27.7	3.1	34	38.3	58.4	3.4
Central African Republic	3 912	42.9	94.7	2.1	1.4	98.6	4.8	170	42.9	53.7	3.4
Chad	**8 854**	**24.4**	**98.0**	**3.1**	**3.0**	**111.6**	**6.6**	**194**	**47.0**	**51.6**	**1.4**
Comoros	790	34.9	101.0	2.9	2.8	63.5	4.7	86	42.0	57.1	0.9
Congo	**3 818**	**56.0**	**97.6**	**3.2**	**2.6**	**80.3**	**6.2**	**120**	**47.2**	**51.4**	**1.4**
Congo. Dem. Rep.	**54 417**	**34.5**	**98.2**	**2.0**	**2.7**	**117.7**	**6.6**	**211**	**47.1**	**52.1**	**0.8**
Côte d'Ivoire	**16 897**	**46.6**	**103.8**	**2.0**	**1.6**	**97.7**	**4.5**	**167**	**40.8**	**56.7**	**2.4**
Djibouti	712	82.1	98.9	2.9	1.8	99.1	5.5	171	42.7	54.5	2.9
Egypt	**73 390**	**46.3**	**99.6**	**1.9**	**2.0**	**37.9**	**3.2**	**44**	**34.4**	**62.3**	**3.3**
Equatorial Guinea	507	51.7	98.0	2.6	2.7	97.6	5.7	167	44.0	53.7	2.3
Eritrea	4 297	20.2	99.1	2.6	3.6	70.2	5.2	102	45.2	54.9	-0.1
Ethiopia	**72 420**	**18.7**	**98.7**	**2.7**	**2.5**	**96.9**	**6.0**	**167**	**45.3**	**53.1**	**1.6**
Gabon	**1 351**	**83.6**	**99.1**	**2.6**	**1.9**	**53.9**	**3.8**	**87**	**40.1**	**56.5**	**3.3**
Gambia	1 462	34.9	98.1	3.3	2.7	77.3	4.5	128	40.4	57.3	2.3
Ghana	**21 377**	**43.0**	**99.1**	**2.3**	**2.2**	**55.0**	**3.9**	**88**	**39.3**	**58.6**	**2.2**
Guinea	8 620	33.9	101.4	2.2	1.6	98.2	5.6	168	44.1	54.3	1.6
Guinea Bissau	1 538	22.0	97.6	2.8	2.9	116.3	6.9	203	47.4	51.2	1.4
Kenya	**32 420**	**36.3**	**97.9**	**2.3**	**1.5**	**66.4**	**3.8**	**114**	**40.8**	**56.9**	**2.3**
Lesotho	1 800	40.3	86.5	1.2	0.3	88.5	3.7	147	39.4	55.4	5.2
Liberia	3 487	49.6	99.9	5.9	4.4	142.8	6.7	222	46.6	52.6	0.9
Libya	5 659	96.6	106.5	1.9	1.9	19.8	2.9	22	30.5	66.8	2.7
Madagascar	**17 901**	**32.1**	**99.0**	**2.9**	**2.9**	**88.1**	**5.5**	**141**	**44.4**	**54.2**	**1.4**
Malawi	12 337	29.8	97.8	2.3	2.1	111.3	5.9	179	46.5	50.9	2.6
Mali	**13 409**	**30.4**	**98.4**	**2.8**	**3.0**	**114.7**	**6.9**	**175**	**49.4**	**49.9**	**0.6**

Table 13 - Demographic Indicators *(cont.)*

	Total population (thousands)	Urban population (% of total)	Sex ratio (males per 100 females)	Population growth rate (%)		Infant mortality rate (per 1000)	Total fertility rate	Mortality under age 5 (per 1000)	Distribution by age (%)		
	2004	2004	2004	1995-2000	2000-2005	2004	2004	2004	0-14	15-64 2004	65+
Mauritania	2 980	61.8	97.7	2.8	3.0	93.3	5.7	150	43.1	55.2	1.7
Mauritius*	**1 233**	**41.4**	**98.6**	**1.1**	**1.0**	**15.4**	**1.9**	**17**	**24.7**	**69.5**	**5.8**
Morocco	**31 064**	**57.4**	**100.3**	**1.6**	**1.6**	**39.3**	**2.7**	**48**	**30.9**	**65.7**	**3.4**
Mozambique	**19 182**	**48.7**	**93.1**	**2.4**	**1.8**	**118.3**	**5.5**	**208**	**43.7**	**53.9**	**2.4**
Namibia	2 011	29.7	95.6	2.8	1.6	57.2	4.3	103	42.7	53.8	3.5
Niger	**12 415**	**22.2**	**102.0**	**3.4**	**3.6**	**121.7**	**7.9**	**203**	**50.3**	**49.7**	**0.0**
Nigeria	**127 117**	**45.5**	**101.5**	**2.8**	**2.6**	**75.7**	**5.2**	**127**	**44.1**	**54.1**	**1.8**
Rwanda	8 481	6.7	91.2	6.5	3.0	107.4	5.5	171	44.9	52.5	2.6
São Tomé and Principe	165	47.6	97.6	2.5	2.6	30.0	3.8	39	40.8	56.3	2.9
Senegal	**10 339**	**51.2**	**98.7**	**2.4**	**2.4**	**58.5**	**4.8**	**108**	**42.8**	**56.2**	**1.0**
Seychelles	85	63.5	...	1.3	1.3	...	...	...	...	...	...
Sierra Leone	5 168	40.4	96.5	1.3	3.6	172.4	6.4	300	44.2	54.7	1.0
Somalia	10 312	33.4	98.5	3.1	4.2	111.9	7.1	185	48.3	51.7	0.0
South Africa	**45 214**	**47.4**	**95.4**	**1.5**	**0.7**	**46.2**	**2.5**	**79**	**32.5**	**63.3**	**4.2**
Sudan	34 333	37.3	101.3	2.3	2.2	74.0	4.2	122	39.2	58.4	2.5
Swaziland	1 083	28.8	91.7	2.1	0.9	75.5	4.3	143	43.0	53.4	3.6
Tanzania	**37 671**	**36.5**	**98.3**	**2.5**	**2.0**	**99.5**	**4.9**	**160**	**44.6**	**54.0**	**1.4**
Togo	5 017	36.4	98.2	3.2	2.5	78.3	5.1	131	43.4	54.5	2.1
Tunisia	**9 937**	**69.6**	**101.4**	**1.3**	**1.1**	**22.1**	**2.0**	**25**	**26.9**	**67.8**	**5.3**
Uganda	**26 699**	**14.6**	**99.0**	**2.9**	**3.2**	**82.6**	**7.0**	**140**	**50.4**	**49.0**	**0.5**
Zambia	**10 924**	**37.0**	**99.1**	**2.2**	**1.3**	**101.2**	**5.5**	**179**	**46.6**	**50.8**	**2.6**
Zimbabwe	12 932	35.9	99.1	1.6	0.6	56.4	3.7	111	42.3	54.0	3.7
Africa	**868 097**	**39.7**	**99.1**	**2.4**	**2.2**	**79.3**	**4.8**	**131**	**41.8**	**56.1**	**2.1**

Note: * Including Agalega, Rodrigues and Saint Brandon.

Sources: United Nations, Department of Economic and Social Affairs, Population Division, *World Population Prospects*, The 2002 Revision.

Table 14 - Poverty and Income Distribution Indicators

	National poverty line* Population below the poverty line (%)				International poverty line Population below the poverty line (%)				Gini Coefficient**	Share of consumption (%)	
	Survey year	Rural	Urban	National	Survey year	Below $1	Below $2	Survey year		Lowest 10%	Highest 10%
Algeria	**1998**	**16.6**	**7.3**	**12.2**	**1995**	**< 2**	**15.1**	**1995**	**35.3**	**2.8**	**26.8**
Angola	**2001**	**94.3**	**57.0**	**68.0**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Benin	**2002**	**31.6**	**23.6**	**28.5**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Botswana	**1993-94**	**55.0**	**29.0**	**47.0**	**1985-86**	**33.3**	**61.4**	**1993**	**63.0**	**0.7**	**56.6**
Burkina Faso	**2003**	**52.3**	**19.9**	**46.4**	**1994**	**61.2**	**85.8**	**1998**	**48.2**	**1.8**	**46.3**
Burundi	1990	36.0	43.0	36.2	1998	58.3	...	1998	33.3	1.7	32.8
Cameroon	**2001**	**49.9**	**22.1**	**40.2**	**1996**	**33.4**	**...**	**2001**	**44.6**	**1.8**	**36.5**
Cape Verde	...	...	...	...	...	...	...	...	...	...	...
Central African Republic	...	...	...	...	1993	66.6	84.0	1993	61.3	0.7	47.7
Chad	**1995-1996**	**67.0**	**63.0**	**64.0**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Comoros	...	...	...	...	...	...	...	1995	33.9	...	...
Congo	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Congo, Dem. Rep.	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Côte d'Ivoire	**1998**	**41.8**	**23.4**	**33.6**	**1995**	**12.3**	**49.4**	**1998**	**45.2**	**3.0**	**28.8**
Djibouti	1996	86.5	...	45.1	...	...	...	1996	38.6	2.3	29.9
Egypt	**1999-2000**	**...**	**...**	**16.7**	**1995**	**3.1**	**52.7**	**1999**	**34.4**	**3.7**	**29.5**
Equatorial Guinea	...	...	...	...	...	...	...	...	...	...	...
Eritrea	1993-1994	...	...	53.0	...	...	...	...	...	...	...
Ethiopia	**1999-2000**	**45.0**	**37.0**	**44.2**	**1995**	**31.3**	**76.4**	**2000**	**30.0**	**0.7**	**43.8**
Gabon	**1994**	**...**	**...**	**62***	**1994**	**23.0**	**...**	**1977**	**63.2**	**...**	**...**
Gambia	1998	...	...	64.0	1998	59.3	...	1998	38.0	1.5	38.0
Ghana	**1998-99**	**51.6**	**22.8**	**42.6**	**1998**	**38.8**	**74.6**	**1998**	**29.5**	**2.4**	**29.5**
Guinea	1994	...	...	40.0	...	...	...	1994	40.3	2.6	32.0
Guinea Bissau	1991	...	...	48.7	...	...	...	1993	47.0	2.1	39.3
Kenya	**1997**	**61.0**	**48.0**		**1994**	**26.5**	**62.3**	**1994**	**44.5**	**1.8**	**34.9**
Lesotho	1993	53.9	27.8	49.2	1993	43.1	65.7	1995	63.2	0.5	53.6
Liberia	...	...	...	...	...	...	...	...	...	...	...
Libya	...	...	...	...	...	...	...	...	...	...	...
Madagascar	**1999**	**76.7**	**52.1**	**71.3**	**1993**	**60.2**	**88.8**	**2001**	**47.5**	**2.5**	**28.6**
Malawi	1997-1998	66.5	54.9	65.3	1997-98	41.7	...	1997	50.3	1.9	42.2
Mali	**1999**	**71.0**	**31.0**	**64.2**	**1994**	**72.8**	**90.6**	**1994**	**50.5**	**1.8**	**40.4**

Table 14 - Poverty and Income Distribution Indicators *(cont.)*

	National poverty line* Population below the poverty line (%)				International poverty line Population below the poverty line (%)				Gini Coefficient**	Share of consumption (%)	
	Survey year	Rural	Urban	National	Survey year	Below 1$	Below 2$	Survey year		Lowest 10%	Highest 10%
Mauritania	2000	61.2	25.4	46.3	1995	3.8	22.1	2000	39.0	2.5	28.4
Mauritius	**1992**	**...**	**...**	**10.6**	**...**	**...**	**...**	**1991**	**36.7**	**...**	**...**
Morocco	**1999**	**27.2**	**12.0**	**19.0**	**1990-91**	**< 2**	**7.5**	**1999**	**39.5**	**2.6**	**30.9**
Mozambique	**2002/03**	...	...	**54.0**	**1996**	**37.9**	**78.4**	**1997**	**39.6**	**2.5**	**31.7**
Namibia	...	...	...	...	1993	34.9	55.8	1993	70**	0.5	64.5
Niger	**1993**	**66.0**	**52.0**	**63.0**	**1995**	**61.4**	**85.3**	**1995**	**50.5**	**0.8**	**35.4**
Nigeria	**1993**	**36.4**	**30.4**	**34.1**	**1997**	**70.2**	**90.8**	**1997**	**50.6**	**1.6**	**40.8**
Rwanda	**1993**	**...**	**...**	**51.2**	**1983-85**	**35.7**	**84.6**	**1985**	**28.9**	**4.2**	**24.2**
São Tomé and Principe	...	...	...	...	...	...	...	...	...	...	...
Senegal	**2001**	**...**	**...**	**53.9**	**1995**	**26.3**	**67.8**	**1995**	**41.3**	**2.6**	**33.5**
Seychelles	...	...	...	...	...	...	...	1984	47.0	...	...
Sierra Leone	1989	76.0	53.0	68.0	1989	57.0	74.5	1989	62.9	0.5	43.6
Somalia	...	...	...	...	...	...	...	...	...	...	...
South Africa	**2000**	**...**	**...**	**45.0**	**1993**	**11.5**	**35.8**	**1995**	**59.3**	**0.7**	**46.9**
Sudan	...	...	...	...	...	...	...	...	...	...	...
Swaziland	1995	...	...	40.0	...	...	...	1994	60.9	1.0	50.2
Tanzania	**2000-2001**	**38.7**	**...**	**35.7**	**1993**	**19.9**	**59.7**	**1993**	**38.2**	**2.8**	**30.1**
Togo	1989	...	...	32.3	...	...	...	...	...	...	...
Tunisia	**1995**	**13.9**	**3.6**	**7.6**	**1990**	**< 2**	**11.6**	**2000**	**39.8**	**2.3**	**31.8**
Uganda	**1999-2000**	**10.3**	**39.1**	**35.2**	**1992**	**36.7**	**77.2**	**1996**	**37.4**	**3.0**	**29.8**
Zambia	**1998**	**83.0**	**56.0**	**73.0**	**1996**	**72.6**	**91.7**	**1998**	**52.6**	**1.1**	**41.0**
Zimbabwe	1995-96	48.0	7.9	34.9	1990-91	36.0	64.2	1995	56.8	1.8	40.3

Note: * The national poverty line is defined as two-thirds of the average consumption.
** The Gini coefficient is defined on consumption.

Sources: Domestic authorities and World Bank (2004), *World Development Report.*

Table 15 - **Basic Health Indicators**

	Life expectancy at birth (years)			Undernourishment prevalence (%)	Food availability (Kcal/person/day)	Total health expenditure				Public health exp. (% of total government expenditure)
		With AIDS	Without AIDS			as % of GDP	Per capita ($)	Distribution Public (%)	Distribution Private (%)	
	2004	2000-2005		2000-2002	2002	2001				2001
Algeria	**70.2**	**69.7**	**...**	**6**	**3 022**	**4.1**	**73.0**	**75.0**	**25.0**	**9.9**
Angola	**40.2**	**40.1**	**44.1**	**40**	**2 083**	**4.6**	**31.0**	**63.1**	**36.9**	**5.5**
Benin	**50.8**	**50.6**	**53.8**	**14**	**2 548**	**3.2**	**16.0**	**46.9**	**53.1**	**10.9**
Botswana	**36.7**	**39.7**	**68.1**	**35**	**2 151**	**3.5**	**190.0**	**66.2**	**33.8**	**7.6**
Burkina Faso	**46.6**	**45.7**	**54.2**	**19**	**2 462**	**4.0**	**6.0**	**60.1**	**39.9**	**8.1**
Burundi	41.7	40.9	51.5	69	1 649	2.3	4.0	59.0	41.0	8.1
Cameroon	**45.1**	**46.2**	**56.1**	**25**	**2 273**	**2.7**	**20.0**	**37.1**	**62.9**	**7.8**
Cape Verde	70.8	70.2	...	...	3 243	2.6	46.0	74.2	25.8	8.8
Central African Rep.	39.6	39.5	53.4	42	1 980	2.4	12.0	51.2	48.8	18.5
Chad	**45.4**	**44.7**	**48.8**	**33**	**2 114**	**2.9**	**5.0**	**76.0**	**24.0**	**15.2**
Comoros	61.6	60.8	...	25	1 754	4.9	9.0	60.0	40.0	5.8
Congo	**48.9**	**48.2**	**58.1**	**37**	**2 162**	**3.0**	**18.0**	**63.8**	**36.2**	**5.7**
Congo, Dem. Rep.	**42.6**	**41.8**	**48.0**	**71**	**1 599**	**1.7**	**5.0**	**44.4**	**55.6**	**10.3**
Côte d'Ivoire	**41.8**	**41.0**	**52.6**	**14**	**2 631**	**2.9**	**41.0**	**16.0**	**84.0**	**6.0**
Djibouti	45.5	45.7	52.3	...	2 220	4.9	41.0	46.3	53.7	5.9
Egypt	**69.4**	**68.8**	**...**	**3**	**3 338**	**4.6**	**56.0**	**30.8**	**69.2**	**4.4**
Equatorial Guinea	49.2	49.1	52.0	...	...	4.2	76.0	60.4	39.6	10.0
Eritrea	53.0	52.7	55.2	72	1 513	5.4	10.0	65.1	34.9	4.5
Ethiopia	**45.9**	**45.5**	**52.5**	**47**	**1 857**	**5.2**	**3.0**	**40.5**	**59.5**	**4.9**
Gabon	**57.4**	**56.6**	**63.0**	**8**	**2 637**	**3.0**	**127.0**	**47.9**	**52.1**	**7.3**
Gambia	54.9	54.1	56.5	29	2 273	3.2	19.0	49.4	50.6	13.6
Ghana	**58.6**	**57.9**	**62.6**	**13**	**2 667**	**4.3**	**12.0**	**59.6**	**40.4**	**8.6**
Guinea	49.9	49.1	51.5	26	2 409	3.6	13.0	54.1	45.9	11.3
Guinea Bissau	45.7	45.3	47.8	25	2 024	4.0	8.0	53.8	46.2	7.4
Kenya	**44.2**	**44.6**	**61.3**	**33**	**2 090**	**7.6**	**29.0**	**21.4**	**78.6**	**6.2**
Lesotho	33.7	35.1	59.0	11	2 638	6.0	23.0	78.9	21.1	12.0
Liberia	41.4	41.4	46.0	45	1 900	2.4	1.0	75.9	24.1	10.6
Libya	73.2	72.8	...	...	3 320	3.9	344.0	47.6	52.4	2.7
Madagascar	**54.4**	**53.6**	**...**	**37**	**2 005**	**2.3**	**6.0**	**65.9**	**34.1**	**7.7**
Malawi	37.7	37.5	55.2	33	2 155	7.2	13.0	35.0	65.0	12.3
Mali	**49.3**	**48.6**	**50.6**	**29**	**2 174**	**4.4**	**11.0**	**38.6**	**61.4**	**6.8**

Table 15 - **Basic Health Indicators** *(cont.)*

	Life expectancy at birth (years)			Undernourishment prevalence (%)	Food availability (Kcal/person/day)	Total health expenditure				Public health exp. (% of total government expenditure)
		With AIDS	Without AIDS			as % of GDP	Per capita ($)	Distribution Public (%)	Private (%)	
	2004	2000-2005		2000-2002	2002	2001				2001
Mauritania	53.3	52.5	...	11	2 772	3.3	12.0	72.4	27.6	10.3
Mauritius*	**72.4**	**72***	**...**	**8**	**2 955**	**3.4**	**128.0**	**59.5**	**40.5**	**7.6**
Morocco	**69.3**	**68.7**	**...**	**7**	**3 052**	**4.4**	**54.0**	**30.0**	**70.0**	**3.9**
Mozambique	**37.9**	**38.1**	**48.5**	**47**	**2 079**	**3.8**	**11.0**	**67.4**	**32.6**	**18.9**
Namibia	42.3	44.3	65.4	21	2 278	8.2	110.0	69.3	30.7	12.2
Niger	**47.0**	**46.2**	**...**	**34**	**2 130**	**3.0**	**6.0**	**39.1**	**60.9**	**7.7**
Nigeria	**51.3**	**51.5**	**57.6**	**9**	**2 726**	**2.1**	**15.0**	**23.2**	**76.8**	**1.9**
Rwanda	**40.1**	**39.3**	**50.7**	**38**	**2 084**	**5.0**	**11.0**	**55.5**	**44.5**	**14.2**
São Tomé and Principe	70.4	69.9	...	...	2 460	2.9	7.0	67.7	32.3	3.5
Senegal	**53.7**	**52.9**	**...**	**24**	**2 280**	**4.5**	**22.0**	**58.8**	**41.2**	**12.9**
Seychelles	...	...	...	...	2 465	6.9	450.0	68.2	31.8	7.0
Sierra Leone	34.2	34.2	37.9	50	1 936	2.8	7.0	61.0	39.0	9.4
Somalia	49.1	47.9	...	71	...	2.0	4.0	62.4	37.6	4.5
South Africa	**45.2**	**47.7**	**66.6**	**...**	**2 956**	**8.7**	**222.0**	**41.4**	**58.6**	**10.9**
Sudan	55.6	55.6	57.5	26	2 228	4.2	121.0	24.1	75.9	4.4
Swaziland	32.6	34.4	62.2	18	2 322	3.7	41.0	68.5	31.5	7.5
Tanzania	**43.5**	**43.3**	**52.1**	**44**	**1 975**	**4.9**	**12.0**	**46.7**	**53.3**	**12.1**
Togo	50.0	49.7	57.0	26	2 345	2.4	8.0	48.6	51.4	9.6
Tunisia	**73.2**	**72.8**	**...**	**1**	**3 238**	**5.3**	**115.0**	**41.3**	**58.7**	**7.0**
Uganda	**48.4**	**46.2**	**55.5**	**19**	**2 410**	**3.5**	**14.0**	**57.5**	**42.5**	**16.4**
Zambia	**32.8**	**32.4**	**53.4**	**49**	**1 927**	**5.6**	**19.0**	**53.1**	**46.9**	**13.5**
Zimbabwe	32.3	33.1	67.6	44	1 943	10.8	45.0	45.3	54.7	8.0
Africa	**50.8**	**50.6**	**57.8**	**28**	**2 431**	**5.2**	**41.1**	**42.5**	**57.5**	**10.4**

Note: * Including Agalega, Rodrigues and Saint Brandon.

Sources: Life Expectancy at Birth: United Nations, Department of Economic and Social Affairs, Population Division, *World Population Prospects*, The 2002 Revision.
Undernourishment prevalence and food availability: FAO, 2002, *The State of Food Insecurity in the World 2002.*
Total health expenditure and public health expenditure: WHO, 2004, *The World Health Report 2004.*

Table 16 - Sanitary Conditions

	Healthy life expectancy at birth (years)			Water supply coverage (%)			Sanitation coverage (%)			Health personnel (per 100 000)		
	Total	Male	Female	Total	Urban	Rural	Total	Urban	Rural	Survey year	Physicians	Nurses
		2002			2002			2002				
Algeria	**60.6**	**59.7**	**61.6**	**87**	**92**	**80**	**92**	**99**	**82**	**1995**	**84.6**	**297.8**
Angola	**33.4**	**31.6**	**35.1**	**50**	**70**	**40**	**30**	**56**	**16**	**1997**	**7.7**	**114.5**
Benin	**44.0**	**43.4**	**44.5**	**68**	**79**	**60**	**32**	**58**	**12**	**1995**	**5.7**	**20.4**
Botswana	**35.7**	**36.0**	**35.4**	**95**	**100**	**90**	**41**	**57**	**25**	**1994**	**23.8**	**219.1**
Burkina Faso	**35.6**	**34.9**	**36.3**	**51**	**82**	**44**	**12**	**45**	**5**	**1995**	**3.4**	**19.6**
Burundi	35.1	33.4	36.8	79	90	78	36	47	35	...	...	...
Cameroon	**41.5**	**41.1**	**41.8**	**63**	**84**	**41**	**48**	**63**	**33**	**1996**	**7.4**	**36.7**
Cape Verde	60.8	58.8	62.9	80	86	73	42	61	19	1996	17.1	55.6
Central African Republic	37.4	37.0	37.7	75	93	61	27	47	12	1995	3.5	8.8
Chad	**40.7**	**39.7**	**41.7**	**34**	**40**	**32**	**8**	**30**	**0**	**1994**	**3.3**	**14.7**
Comoros	54.6	53.9	55.3	94	90	96	23	38	15	1997	7.4	34.1
Congo	**46.3**	**45.3**	**47.3**	**46**	**72**	**17**	**9**	**14**	**2**	**1995**	**25.1**	**185.1**
Congo, Dem. Rep.	**37.1**	**35.0**	**39.1**	**84**	**98**	**74**	**40**	**61**	**23**	**1996**	**6.9**	**44.2**
Côte d'Ivoire	**39.5**	**37.6**	**41.3**	**46**	**83**	**29**	**29**	**43**	**23**	**1996**	**9.0**	**31.2**
Djibouti	42.9	42.5	43.2	80	82	67	50	55	27	1996	14.0	74.0
Egypt	**59.0**	**57.8**	**60.2**	**98**	**100**	**97**	**68**	**84**	**56**	**1996**	**202.0**	**233.0**
Equatorial Guinea	45.5	44.7	46.3	44	45	42	53	60	46	1996	24.6	39.5
Eritrea	50.0	49.3	50.8	57	72	54	9	34	3	1996	3.0	16.0
Ethiopia	**41.2**	**40.7**	**41.7**	**22**	**81**	**11**	**6**	**19**	**4**	**...**	**...**	**...**
Gabon	**51.4**	**50.2**	**52.6**	**87**	**95**	**47**	**36**	**37**	**30**	**...**	**...**	**...**
Gambia	49.5	48.5	50.5	82	95	77	53	72	46	1997	3.5	12.5
Ghana	**49.8**	**49.2**	**50.3**	**79**	**93**	**68**	**58**	**74**	**46**	**1996**	**6.2**	**72.0**
Guinea	44.8	43.9	45.6	51	78	38	13	25	6	1995	13.0	55.7
Guinea Bissau	40.5	39.6	41.5	59	79	49	34	57	23	1996	16.6	109.4
Kenya	**44.4**	**44.1**	**44.8**	**62**	**89**	**46**	**48**	**56**	**43**	**1995**	**13.2**	**90.1**
Lesotho	31.4	29.6	33.2	76	88	74	37	61	32	1995	5.4	60.1
Liberia	35.3	33.6	37.0	62	72	52	26	49	7	1997	2.3	5.9
Libya	63.7	62.3	65.0	72	72	68	97	97	96	1997	128.0	360.0
Madagascar	**48.6**	**47.3**	**49.9**	**45**	**75**	**34**	**33**	**49**	**27**	**1996**	**10.7**	**21.6**
Malawi	34.9	35.0	34.8	67	96	62	46	66	42	...	...	...
Mali	**37.9**	**37.5**	**38.3**	**48**	**76**	**35**	**45**	**59**	**38**	**1994**	**4.7**	**13.1**

Table 16 - **Sanitary Conditions** *(cont.)*

	Healthy life expectancy at birth (years)			Water supply coverage (%)			Sanitation coverage (%)			Health personnel (per 100 000)		
	Total	Male	Female	Total	Urban	Rural	Total	Urban	Rural	Survey year	Physicians	Nurses
		2002			2002			2002				
Mauritania	44.5	42.8	46.3	56	63	45	42	64	9	1995	13.8	62.4
Mauritius	**62.4**	**60.3**	**64.6**	**100**	**100**	**100**	**99**	**100**	**99**	**1995**	**85.0**	**232.9**
Morocco	**60.2**	**59.5**	**60.9**	**80**	**99**	**56**	**61**	**83**	**31**	**1997**	**46.0**	**105.0**
Mozambique	**36.9**	**36.3**	**37.5**	**42**	**76**	**24**	**27**	**51**	**14**	**...**	**...**	**...**
Namibia	43.3	42.9	43.8	80	98	72	30	66	14	1997	29.5	168.0
Niger	**35.5**	**35.8**	**35.2**	**46**	**80**	**36**	**12**	**43**	**4**	**1997**	**3.5**	**22.9**
Nigeria	**41.5**	**41.3**	**41.8**	**60**	**72**	**49**	**38**	**48**	**30**	**1992**	**18.5**	**66.1**
Rwanda	**38.3**	**36.4**	**40.2**	**73**	**92**	**69**	**41**	**56**	**38**	**...**	**...**	**...**
São Tomé and Principe	54.4	54.2	54.7	79	89	73	24	32	20	1996	46.7	127.4
Senegal	**48.0**	**47.1**	**48.9**	**72**	**90**	**54**	**52**	**70**	**34**	**1995**	**7.5**	**22.1**
Seychelles	61.2	57.4	64.9	87	100	75	...	...	100	1996	132.4	467.6
Sierra Leone	28.6	27.2	29.9	57	75	46	39	53	30	1996	7.3	33.0
Somalia	36.8	36.1	37.5	29	32	27	25	47	14	1997	4.0	20.0
South Africa	**44.3**	**43.3**	**45.3**	**87**	**98**	**73**	**67**	**86**	**44**	**1996**	**56.3**	**471.8**
Sudan	48.5	47.2	49.9	69	78	64	34	50	24	1996	9.0	58.0
Swaziland	34.2	33.2	35.2	52	87	42	52	78	44	1996	15.1	...
Tanzania	**40.4**	**40.0**	**40.7**	**51**	**80**	**36**	**34**	**71**	**15**	**1995**	**4.1**	**85.2**
Togo	44.6	43.5	45.7	82	94	60	80	90	62	1995	7.6	29.7
Tunisia	**62.5**	**61.3**	**63.6**	**73**	**92**	**62**	**46**	**54**	**41**	**1997**	**70.0**	**286.0**
Uganda	**42.7**	**41.7**	**43.7**	**56**	**87**	**52**	**41**	**53**	**39**	**1996**	**...**	**18.7**
Zambia	**34.9**	**34.8**	**35.0**	**55**	**90**	**36**	**45**	**68**	**32**	**1995**	**6.9**	**113.1**
Zimbabwe	33.6	33.8	33.3	83	100	74	57	69	51	1995	13.9	128.7
Africa	**44.6**	**43.8**	**45.3**	**64**	**85**	**50**	**43**	**63**	**30**	**...**	**...**	**...**

Sources: Healthy Life Expectancy at Birth: WHO, 2004, *The World Health Report 2004.*
Water supply coverage and sanitation coverage: WHO and UNICEF, Joint Monitoring Programme online (http://www.wssinfo.org/en/sanquery.html) 2004;
Health personnel: WHO, *Global Atlas of the Health Workforce, 2004.*

Table 17 - Major Diseases

	Total population (000)	People living with HIV/AIDS (000)	HIV/AIDS Adult prevalence (%)	AIDS orphans cumulative (000)	Malaria notified cases		Tuberculosis notified cases	Measles incidence	Vaccination coverage (%)	
									MCV	DTP3
	2004		end-2003		Survey year	Notified cases	2003	2003	2003	
Algeria	32 339	9	0.1	...	1 997	197	19 730	15 374	84	87
Angola	14 078	240	3.9	110	1 995	156 603	36 079	1 196	62	46
Benin	6 918	68	1.9	34	1 997	670 857	2 932	217	83	88
Botswana	1 795	350	37.3	120	1 995	17 599	9 862	59	90	93
Burkina Faso	13 393	300	4.2	260	1 995	501 020	2 620	2 946	76	84
Burundi	7 068	250	6.0	200	1 995	932 794	6 822	224	81	94
Cameroon	16 296	560	6.9	240	1 997	645 309	15 964	899	61	73
Cape Verde	473	...	...	...	1 997	20	205	0	76	87
Central African Republic	3 912	260	13.5	110	...	...	4 837	652	35	28
Chad	8 854	200	4.8	96	1 995	343 186	5 077	15 801	61	47
Comoros	790	...	...	...	1 996	15 509	...	0	63	75
Congo	3 818	90	4.9	97	1 997	9 491	7 782	3 712	50	50
Congo, Dem. Rep.	54 417	1 100	4.2	770	...	...	84 687	21 956	56	49
Côte d'Ivoire	16 897	570	7.0	310	1 997	983 089	17 782	5 207	54	54
Djibouti	712	9	2.9	5	1 997	4 314	3 231	37	66	68
Egypt	73 390	12	0.0	...	1 997	11	11 490	164	98	98
Equatorial Guinea	507	...	...	...	1 995	12 530	416	18	36	41
Eritrea	4 297	60	2.7	39	...	...	2 805	376	63	75
Ethiopia	72 420	1 500	4.4	720	1 994	358 469	117 600	228	44	52
Gabon	1 351	48	8.1	14	1 997	35 842	2 174	...	37	40
Gambia	1 462	7	1.2	2	...	...	1 945	119	90	90
Ghana	21 377	350	3.1	170	1 997	2227 762	11 891	1 939	80	80
Guinea	8 620	140	3.2	35	1 997	802 210	6 199	2 497	75	69
Guinea Bissau	1 538	...	...	...	...	...	1 600	1 158	61	77
Kenya	32 420	1 200	6.7	650	1 995	4343 190	91 522	65	72	73
Lesotho	1 800	320	28.9	100	...	...	10 111	1	55	62
Liberia	3 487	100	5.9	36	...	...	1 753	142	53	38
Libya	5 659	10	0.3	...	...	...	1 917	...	...	...
Madagascar	17 901	140	1.7	30	...	...	19 309	62 233	86	87
Malawi	12 337	900	14.2	500	...	...	25 841	167	77	84
Mali	13 409	140	1.9	75	1 997	384 907	4 496	232	68	79

Table 17 - **Major Diseases** *(cont.)*

	Total population (000) 2004	People living with HIV/AIDS (000)	HIV/AIDS Adult prevalence (%) end-2003	AIDS orphans cumulative (000)	Malaria notified cases: Survey year	Malaria notified cases: Notified cases	Tuberculosis notified cases 2003	Measles incidence 2003	Vaccination coverage (%) 2003: MCV	Vaccination coverage (%) 2003: DTP3
Mauritania	2 980	10	0.6	2	...	...	3 067	3 611	71	76
Mauritius	**1 233**	**...**	**...**	**...**	**1 997**	**65**	**...**	**777**	**94**	**92**
Morocco	**31 064**	**15**	**0.1**	**...**	**2 000**	**59**	**26 789**	**10 841**	**90**	**91**
Mozambique	**19 182**	**1 300**	**12.2**	**470**	**...**	**...**	**28 602**	**28 898**	**96**	**85**
Namibia	2 011	210	21.3	57	1 997	425 185	11 776	262	70	92
Niger	**12 415**	**70**	**1.2**	**24**	**1 997**	**978 855**	**7 078**	**54 190**	**64**	**52**
Nigeria	**127 117**	**3 600**	**5.4**	**1 800**	**1 997**	**616 466**	**44 184**	**...**	**...**	**...**
Rwanda	**8 481**	**250**	**5.1**	**160**	**1 997**	**1210 775**	**6 011**	**1 064**	**90**	**96**
São Tomé and Principe	165	...	...	...	...	...	...	0	87	94
Senegal	**10 339**	**44**	**0.8**	**17**	**1 995**	**628 773**	**9 410**	**1 638**	**60**	**73**
Seychelles	85	...	...	...	...	...	...	0	99	99
Sierra Leone	5 168	...	...	...	...	...	5 289	586	73	70
Somalia	10 312	...	...	...	2 000	10 364	9 278	8 257	40	40
South Africa	**45 214**	**5 300**	**21.5**	**1 100**	**1 996**	**29 160**	**227 320**	**244**	**83**	**94**
Sudan	34 333	400	2.3	...	2 000	4332 827	25 095	4 381	70	74
Swaziland	1 083	220	38.8	65	...	...	6 748	350	94	95
Tanzania	**37 671**	**1 600**	**8.8**	**980**	**1 997**	**1131 655**	**61 579**	**1 673**	**72**	**95**
Togo	5 017	110	4.1	54	...	...	1 766	295	90	72
Tunisia	**9 937**	**1**	**0.0**	**...**	**...**	**...**	**1 965**	**22**	**83**	**95**
Uganda	**26 699**	**530**	**4.1**	**940**	**...**	**...**	**41 795**	**29 429**	**97**	**81**
Zambia	**10 924**	**920**	**16.5**	**630**	**1 996**	**3215 866**	**53 932**	**881**	**78**	**91**
Zimbabwe	12 932	1 800	24.6	980	1 995	330 002	53 183	998	80	80
Africa	**868 097**	**28 650**	**7.4***	**12 002**	**...**	**...**	**1 153 546**	**286 016**	**72**	**74**

Notes: DTP: Diphtheria, tetanus toxoids and pertussis antigen. MCV: Measles Contaning Vaccine.
* Sub-Saharan Africa only.

Sources: UNAIDS and WHO, Country epidemic updates September 2004; Malaria notified cases: WHO, Roll Back Malaria (RBM) database; Tuberculosis notified cases: WHO, 2004, Global Tuberculosis Database; Vaccination coverage and Measles incidence: *WHO Vaccine Immunization and Biological,* 2004 Global Summary.

Table 18 - **Basic Education Indicators**

	Estimated adult illiteracy rate, 2004 (%) (people over 15)			Estimated youth illiteracy rate, 2004 (%) (people between 15 and 24)			Public expenditure on education 1998-2002 (% of GNI)
	Total	Male	Female	Total	Male	Female	
Algeria	**29.0**	**20.3**	**37.9**	**8.7**	**5.2**	**12.3**	**...**
Angola	**...**	**...**	**...**	**...**	**...**	**...**	**3.4**
Benin	**58.0**	**42.5**	**72.6**	**42.2**	**25.0**	**59.1**	**3.3**
Botswana	**19.4**	**22.2**	**16.8**	**10.0**	**13.6**	**6.5**	**2.3**
Burkina Faso	**72.5**	**62.2**	**82.6**	**60.9**	**50.0**	**71.9**	**...**
Burundi	47.3	40.8	53.3	31.7	31.5	31.9	3.7
Cameroon	**24.2**	**17.6**	**30.7**	**7.8**	**6.5**	**9.1**	**3.4**
Cape Verde	22.9	13.8	30.2	9.8	7.3	12.3	4.4
Central African Republic	47.5	35.6	58.4	27.3	20.7	33.8	1.9
Chad	**51.0**	**42.6**	**58.9**	**27.1**	**22.0**	**32.3**	**2.0**
Comoros	43.4	36.2	50.5	40.7	34.1	47.4	3.8
Congo	**15.2**	**9.6**	**20.5**	**1.7**	**1.2**	**2.2**	**4.6**
Congo, Dem. Rep.	**33.2**	**22.8**	**43.3**	**14.6**	**9.3**	**19.8**	**...**
Côte d'Ivoire	**47.3**	**37.2**	**58.0**	**34.6**	**26.7**	**42.6**	**4.9**
Djibouti	30.8	21.0	40.0	12.8	9.5	16.2	3.4
Egypt	**41.5**	**31.1**	**52.1**	**27.3**	**21.7**	**33.1**	**...**
Equatorial Guinea	13.6	6.2	20.8	2.2	1.1	3.2	2.2
Eritrea	40.5	29.3	51.3	26.4	17.3	35.4	2.7
Ethiopia	**56.0**	**48.7**	**63.4**	**40.2**	**35.1**	**45.2**	**4.8**
Gabon	**...**	**...**	**...**	**...**	**...**	**...**	**4.6**
Gambia	58.7	51.4	65.8	37.0	29.5	44.4	2.8
Ghana	**24.1**	**16.6**	**31.3**	**6.7**	**5.1**	**8.3**	**4.2**
Guinea	...	...	...	...	...	...	1.9
Guinea Bissau	56.5	41.1	71.1	36.4	23.8	48.9	2.3
Kenya	**14.0**	**8.9**	**19.1**	**3.6**	**3.2**	**4.0**	**6.3**
Lesotho	14.7	24.8	5.2	8.3	15.4	1.1	8.0
Liberia	42.1	25.8	58.5	27.0	12.3	41.7	...
Libya	16.7	7.1	27.0	2.5	0.2	5.0	...
Madagascar	**30.3**	**23.9**	**36.5**	**17.2**	**14.5**	**20.1**	**2.5**
Malawi	36.5	23.4	49.2	26.1	17.2	35.3	4.2
Mali	**71.3**	**60.8**	**81.3**	**60.1**	**49.1**	**71.2**	**2.9**

Table 18 - **Basic Education Indicators** *(cont.)*

	Estimated adult illiteracy rate, 2004 (%) (people over 15)			Estimated youth illiteracy rate, 2004 (%) (people between 15 and 24)			Public expenditure on education 1998-2002 (% of GNI)
	Total	Male	Female	Total	Male	Female	
Mauritania	57.9	47.8	67.5	49.6	42.2	57.1	3.6
Mauritius	**14.0**	**11.2**	**16.8**	**5.3**	**5.9**	**4.6**	**3.3**
Morocco	**47.5**	**35.2**	**59.6**	**28.3**	**21.2**	**35.6**	**5.2**
Mozambique	**50.9**	**35.4**	**65.8**	**34.9**	**21.9**	**47.7**	**2.5**
Namibia	15.3	15.0	15.5	7.1	8.8	5.4	7.6
Niger	**81.8**	**73.6**	**89.8**	**74.0**	**64.4**	**83.7**	**2.4**
Nigeria	**30.6**	**23.5**	**37.4**	**9.8**	**8.2**	**11.4**	**...**
Rwanda	**28.4**	**23.0**	**33.7**	**13.5**	**12.6**	**14.4**	**2.8**
São Tomé and Principe	...	...	...	...	...	...	...
Senegal	**58.9**	**49.2**	**68.2**	**44.9**	**36.8**	**53.0**	**3.2**
Seychelles	...	...	...	...	...	...	7.8
Sierra Leone	...	...	...	...	...	...	1.0
Somalia	...	...	...	...	...	...	...
South Africa	**13.3**	**12.6**	**13.9**	**7.8**	**7.8**	**7.8**	**5.8**
Sudan	38.0	27.6	48.2	19.0	15.0	23.1	...
Swaziland	17.8	16.9	18.6	7.9	8.8	7.1	5.4
Tanzania	**20.9**	**13.5**	**28.0**	**7.4**	**5.7**	**9.1**	**2.2**
Togo	37.8	23.6	51.5	20.6	10.6	30.5	4.9
Tunisia	**24.8**	**15.2**	**34.5**	**4.8**	**1.6**	**8.0**	**7.2**
Uganda	**29.3**	**20.0**	**38.5**	**18.4**	**12.8**	**24.0**	**2.5**
Zambia	**18.6**	**12.7**	**24.2**	**9.8**	**7.9**	**11.8**	**2.0**
Zimbabwe	8.7	5.3	12.1	2.0	0.8	3.2	4.9
Africa	**35.9**	**27.7**	**44.0**	**20.1**	**15.9**	**24.4**	**...**

Sources: UNESCO Institute for Statistics (UIS) Database.

Table 19 - School Enrolment

	Unesco primary, 2001/2002 Gross enrolment ratio			Net enrolment ratio			Pupil/ teacher ratio	Unesco secondary, 2001/2002 Gross enrolment ratio			Pupil/ teacher ratio
	Total	Male	Female	Total	Male	Female		Total	Male	Female	
Algeria	**108.0**	**112.0**	**104.0**	**95.0**	**96.0**	**94.0**	**28.0**	**72.0**	**69.0**	**74.0**	**20.0**
Angola	**74.0****	**78.0****	**69.0****	**37.0****	**39.0****	**35.0****	**27.5****	**19.0**	**21.0**	**17.0**	**23.0***
Benin	**104.0**	**122.0**	**86.0**	**...**	**...**	**...**	**53.0**	**26.0****	**35.0****	**16.0****	**22.0****
Botswana	**103.0**	**103.0**	**103.0**	**81.0**	**79.0**	**83.0**	**27.0**	**73.0**	**70.0**	**75.0**	**20.0****
Burkina Faso	**44.0****	**51.0****	**36.0****	**35.0****	**41.0****	**29.0****	**47.0****	**10.0****	**12.0****	**8.0***	**...**
Burundi	71.0	80.0	62.0	53.0**	59.0**	48.0**	49.0	11.0**	12.0**	9.0**	...
Cameroon	**107***	**115.0****	**99.0****	**...**	**...**	**...**	**61.0****	**33.0****	**36.0****	**29.0****	**...**
Cape Verde	123.0	125.0	120.0	99.0	100.0	99.0	29.0	66.0	64.0	67.0	24.0
Central African Republic	66.0*	79.0*	53.0**	...	64.0.0**	45.0**	...	...	...	...	...
Chad	**73.0****	**90.0****	**57.0****	**58.0****	**70.0****	**47.0****	**71.0****	**...**	**...**	**...**	**...**
Comoros	90.0	98.0	81.0	56.0**	60.0**	52.0**	39.0	28.0	30.0	25.0	13.0**
Congo	**86.0**	**88.0**	**83.0**	**...**	**...**	**...**	**56.0**	**32.0****	**37.0****	**27.0****	**26.0****
Congo, Dem. Rep.	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
Côte d'Ivoire	**80.0**	**92.0**	**68.0**	**63.0**	**72.0**	**53.0**	**44.0**	**...**	**...**	**...**	**...**
Djibouti	40.0	46.0	35.0	34.0**	38.0**	30.0**	34.0**	20.0	24.0	15.0	28.0**
Egypt	**97.0****	**100.0****	**94.0****	**90.0****	**92.0****	**88.0****	**22.0****	**88.0****	**91.0****	**85.0****	**17.0****
Equatorial Guinea	126.0	132.0	120.0	85.0	91.0	78.0	...	30.0**	38.0**	22.0**	...
Eritrea	61.0	67.0	54.0	43.0	46.0	39.0	44.0	28.0	33.0	22.0	49.0
Ethiopia	**64.0**	**75.0**	**53.0**	**46.0**	**52.0**	**41.0**	**57.0**	**19.0**	**23.0**	**15.0**	**...**
Gabon	**134.0**	**135.0**	**134.0**	**88.0****	**89.0****	**87.0****	**49.0****	**51.0****	**...**	**...**	**...**
Gambia	79.0**	82.0**	75.0**	73.0**	76.0**	70.0**	38.0**	34.0**	40.0**	28.0**	26.0
Ghana	**81.0**	**85.0**	**78.0**	**60.0**	**61.0**	**59.0**	**32.0**	**38.0****	**41.0****	**34.0****	**19.0****
Guinea	77.0	88.0	66.0	61.0	69.0	54.0	47.0	...	...	...	...
Guinea Bissau	...	...	...	...	...	...	...	...	...	...	...
Kenya	**96.0**	**97.0**	**95.0**	**70.0****	**69.0****	**71.0****	**32.0**	**32.0**	**34.0**	**30.0**	**26.0****
Lesotho	124.0	123.0	125.0	84.0	81.0	88.0	47.0	34.0	30.0	38.0	23.0**
Liberia	...	...	...	...	...	...	...	...	...	...	...
Libya	114.0	114.0	114.0	...	...	...	...	105.0	102.0	108.0	...
Madagascar	**104.0**	**106.0**	**102.0**	**69.0**	**68.0**	**69.0**	**47.0**	**...**	**...**	**...**	**...**
Malawi	146.0	149.0	143.0	81.0**	81.0**	81.0**	...	34.0	39.0	29.0	...
Mali	**57.0**	**65.0**	**49.0**	**...**	**...**	**...**	**56.0**	**...**	**...**	**...**	**...**

Table 19 - School Enrolment *(cont.)*

	Unesco primary, 2001/2002 Gross enrolment ratio			Net enrolment ratio			Pupil/ teacher ratio	Unesco secondary, 2001/2002 Gross enrolment ratio			Pupil/ teacher ratio
	Total	Male	Female	Total	Male	Female		Total	Male	Female	
Mauritania	86.0	88.0	85.0	67.0**	68.0**	65.0**	39.0	22.0	25.0	19.0	...
Mauritius	106.0	106.0	106.0	93.0	93.0	93.0	25.0	80.0	81.0	78.0	...
Morocco	107.0	113.0	101.0	88.0	92.0	85.0	28.0	...	...	...	...
Mozambique	99.0	110.0	87.0	60.0	63.0	56.0	66.0	13.0	16.0	10.0	27.0
Namibia	106.0	106.0	106.0	78.0	76.0	81.0	32.0	61.0	57.0	65.0	24.0**
Niger	40.0	47.0	32.0	34.0	41.0	28.0	41.0	6.0	8.0	5.0	27.0
Nigeria	96.0**	107.0**	86.0**	...	...	...	40.0**	...	...	...	...
Rwanda	117.0	118.0	116.0	84.0	83.0	85.0	59.0	14.0**	15.0**	14.0**	...
São Tomé and Principe	126.0**	130.0**	122.0**	97.0**	100.0**	94.0**	33.0**	39.0**	42.0**	36.0**	...
Senegal	75.0	79.0	72.0	58.0	61.0	54.0	49.0	19.0**	22.0**	15.0**	27.0**
Seychelles	116.0	116.0	115.0	...	...	...	14.0	110.0	107.0	113.0	15.0**
Sierra Leone	...	...	...	...	...	...	...	...	...	...	27.0
Somalia	...	...	...	...	...	...	...	...	...	...	...
South Africa	105.0	107.0	103.0	90.0	89.0	90.0	37.0	86.0**	83.0**	90.0**	30.0**
Sudan	59.0	63.0	54.0	49.0**	54.0**	45.0**	...	32.0	...	...	...
Swaziland	100.0	103.0	98.0	77.0	76.0	77.0	32.0	45.0	45.0	45.0	...
Tanzania	70.0	71.0	69.0	54.0	54.0	54.0	47.0	...	...	...	...
Togo	124.0	136.0	112.0	92.0	100.0	84.0	35.0	...	...	...	...
Tunisia	112.0	114.0	109.0	97.0	97.0	97.0	22.0	79.0	78.0	81.0	20.0**
Uganda	136.0	139.0	134.0	...	...	...	54.0	17.0**	19.0**	15.0**	...
Zambia	79.0	81.0	76.0	66.0**	66.0**	66.0**	45.0**	24.0	27.0	21.0	...
Zimbabwe	99.0	100.0	98.0	83.0	82.0	83.0	38.0	43.0	45.0	40.0	24.0**
Africa	90.1	98.8	84.3	68.0	71.3	64.2	40.7	42.9	42.3	41.3	24.2

Note: * National estimation.
** UNESCO Institute for Statistics (UIS) estimation.

Sources: UNESCO Institute for Statistics (UIS) Database.

Table 20 - **Corruption Perception Index**

	1999 Index	1999 Country Rank / 99	2000 Index	2000 Country Rank / 90	2001 Index	2001 Country Rank / 91	2002 Index	2002 Country Rank / 102	2003 Index	2003 Country Rank / 133	2004 Index	2004 Country Rank / 145
Algeria	...	...	...	...	...	...	...	...	2.6	88	2.7	97
Angola	...	...	1.7	85	...	...	1.7	98	1.8	124	2	133
Benin	...	...	...	...	...	...	...	...	...	...	3.2	77
Botswana	6.1	24	6	26	6	26	6.4	24	5.7	30	6	31
Burkina Faso	...	...	3	65	...	...	...	...	...	...	...	...
Burundi	...	...	...	...	...	...	...	...	...	...	...	...
Cameroon	1.5	99	2	84	2	84	2.2	89	1.8	124	2.1	129
Cape Verde	...	...	...	...	...	...	...	...	...	...	...	...
Central African Republic	...	...	...	...	...	...	...	...	...	...	...	...
Chad	...	...	...	...	...	...	...	...	...	...	1.7	142
Comoros	...	...	...	...	...	...	...	...	...	...	...	...
Congo	...	...	...	...	...	...	...	...	2.2	113	2.3	114
Congo, Dem. Rep.	...	...	...	...	...	...	...	...	...	...	2	133
Côte d'Ivoire	2.6	75	2.7	71	2.4	77	2.7	71	2.1	118	2	133
Djibouti	...	...	...	...	...	...	...	...	...	...	...	...
Egypt	3.3	63	3.1	63	3.6	54	3.4	62	3.3	70	3.2	77
Equatorial Guinea	...	...	...	...	...	...	...	...	...	...	...	...
Eritrea	...	...	...	...	...	...	...	...	...	...	2.6	102
Ethiopia	...	...	3.2	60	...	...	3.5	59	2.5	92	2.3	114
Gabon	...	...	...	...	...	...	...	...	...	...	3.3	74
Gambia	...	...	...	...	...	...	...	...	2.5	92	2.8	90
Ghana	3.3	63	3.5	52	3.4	59	3.9	50	3.3	70	3.6	64
Guinea	...	...	...	...	...	...	...	...	...	...	...	...
Guinea Bissau	...	...	...	...	...	...	...	...	...	...	...	...
Kenya	2	90	2.1	82	2	84	1.9	96	1.9	122	2.1	129
Lesotho	...	...	...	...	...	...	...	...	...	...	...	...
Liberia	...	...	...	...	...	...	...	...	...	...	...	...
Libya	...	...	...	...	...	...	...	...	2.1	118	2.5	108
Madagascar	...	...	...	...	...	...	1.7	98	2.6	88	3.1	82
Malawi	4.1	45	4.1	43	3.2	61	2.9	68	2.8	83	2.8	90
Mali	...	...	...	...	...	...	...	...	3	78	3.2	77

Table 20 - Corruption Perception Index

	1999 Index	1999 Country Rank / 99	2000 Index	2000 Country Rank / 90	2001 Index	2001 Country Rank / 91	2002 Index	2002 Country Rank / 102	2003 Index	2003 Country Rank / 133	2004 Index	2004 Country Rank / 145
Mauritania	...	...	...	...	...	...	...	...	...	...	...	...
Mauritius	**4.9**	**36**	**4.7**	**37**	**4.5**	**40**	**4.5**	**40**	**4.4**	**48**	**4.1**	**54**
Morocco	**4.1**	**45**	**4.7**	**37**	**...**	**...**	**3.7**	**52**	**3.3**	**70**	**3.2**	**77**
Mozambique	**3.5**	**56**	**2.2**	**81**	**...**	**...**	**...**	**...**	**2.7**	**86**	**2.8**	**90**
Namibia	5.3	29	5.4	30	5.4	30	5.7	28	4.7	41	4.1	54
Niger	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**2.2**	**122**
Nigeria	**1.6**	**98**	**1.2**	**90**	**1**	**90**	**1.6**	**101**	**1.4**	**132**	**1.6**	**144**
Rwanda	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**
São Tomé and Principe	...	...	...	...	...	...	...	...	...	...	...	...
Senegal	**3.4**	**58**	**3.5**	**52**	**2.9**	**65**	**3.1**	**66**	**3.2**	**76**	**3**	**85**
Seychelles	...	...	...	...	...	...	...	...	...	...	4.4	48
Sierra Leone	...	...	...	...	...	...	...	...	2.2	113	2.3	114
Somalia	...	...	...	...	...	...	...	...	...	...	...	...
South Africa	**5**	**34**	**5**	**34**	**4.8**	**38**	**4.8**	**36**	**4.4**	**48**	**4.6**	**44**
Sudan	...	...	...	...	...	...	...	...	2.3	106	2.2	122
Swaziland	...	...	...	...	...	...	...	...	...	...	...	...
Tanzania	**1.9**	**93**	**2.5**	**76**	**2.2**	**82**	**2.7**	**71**	**2.5**	**92**	**2.8**	**90**
Togo	...	...	...	...	...	...	...	...	...	...	...	...
Tunisia	**5**	**34**	**5.2**	**32**	**5.3**	**31**	**4.8**	**36**	**4.9**	**39**	**5**	**39**
Uganda	**2.2**	**87**	**2.3**	**80**	**1.9**	**88**	**2.1**	**93**	**2.2**	**113**	**2.6**	**102**
Zambia	**3.5**	**56**	**3.4**	**57**	**2.6**	**75**	**2.6**	**77**	**2.5**	**92**	**2.6**	**102**
Zimbabwe	4.1	45	3	65	2.9	65	2.7	71	2.3	106	2.3	114

Source: Transparency International.

Table 21 - Political Troubles

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Algeria	121.4	124.2	126.6	141.6	120.3	142.5	64.8	14.5	61.4
Angola	...	...	...	...	...	...	...	...	54.6
Benin	...	...	...	...	...	...	...	...	2.7
Botswana	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Burkina Faso	0.0	3.2	1.1	5.6	9.5	2.5	2.5	0.1	4.1
Cameroon	23.7	54.7	1.3	1.5	2.2	1.0	0.6	0.8	2.0
Chad	4.4	5.6	2.2	20.2	26.7	16.7	10.5	2.9	3.8
Congo	...	...	...	...	...	...	...	...	2.0
Congo, Dem. Rep.	...	...	...	...	...	...	...	...	21.7
Côte d'Ivoire	16.4	3.8	3.4	21.7	28.1	2.9	13.7	18.8	25.2
Egypt	22.9	43.6	0.0	1.0	7.8	7.2	2.0	5.4	8.5
Equatorial Guinea	1.9	0.0	1.9	0.0	0.0	0.0	0.0	1.0	1.0
Ethiopia	48.5	12.2	1.6	24.8	5.7	8.4	42.6	15.2	25.9
Gabon	10.0	1.0	2.5	0.9	0.0	0.0	1.5	0.0	0.5
Ghana	4.9	0.0	0.3	4.5	1.9	3.8	3.8	1.1	1.9
Kenya	14.8	25.5	34.1	0.0	0.0	11.6	1.9	6.8	4.5
Madagascar	...	...	...	...	...	...	...	...	6.7
Mali	3.4	13.7	1.2	8.8	0.0	0.0	0.0	0.6	0.6
Mauritius	0.0	0.0	0.0	5.2	0.0	0.0	0.0	0.0	1.9
Morocco	12.2	1.6	2.2	0.5	0.5	0.0	0.0	0.0	3.5
Mozambique	37.7	0.0	0.0	2.7	6.8	0.0	0.0	4.5	3.8
Namibia	3.5	0.0	0.0	7.6	3.8	0.0	0.0	0.0	0.0
Niger	...	...	...	...	...	...	...	...	5.5
Nigeria	30.2	51.3	10.2	47.1	29.2	39.7	19.4	10.4	31.6
Rwanda	...	...	...	...	...	...	...	...	0.0
Senegal	0.3	19.6	2.7	5.6	5.7	5.9	7.7	6.7	9.1
South Africa	85.0	40.8	20.3	38.8	18.9	2.2	3.3	1.2	11.3
Tanzania	4.7	1.9	0.9	0.0	0.0	6.0	0.0	0.5	0.3
Tunisia	0.0	0.0	0.5	2.5	0.5	0.0	2.9	2.3	0.0
Uganda	81.3	15.3	10.5	9.6	0.0	23.9	14.3	17.2	41.1
Zambia	4.8	4.6	4.9	3.6	0.6	17.6	1.1	5.7	2.0
Zimbabwe	9.6	9.7	11.3	5.4	16.8	12.6	16.5	8.8	3.4

Note: See note on methodology.
Source: Authors' calculations based on *Marchés Tropicaux et Méditerranéens.*

Table 22 - Softening of the Regime

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Algeria	1.3	3.6	0.8	1.9	0.7	0.0	3.0	2.6	3.8
Angola	...	...	...	...	...	...	...	...	1.2
Benin	...	...	...	...	...	...	...	...	0.9
Botswana	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0
Burkina Faso	0.4	0.4	0.0	0.0	1.1	0.0	0.7	0.1	1.1
Cameroon	0.7	2.0	0.8	0.0	0.1	0.8	0.0	0.7	2.4
Chad	4.5	4.0	0.0	1.8	0.5	1.1	2.7	3.2	0.2
Congo	...	...	...	...	...	...	...	...	0.8
Congo, Dem. Rep.	...	...	...	...	...	...	...	...	0.4
Côte d'Ivoire	1.5	2.1	1.0	1.1	2.6	3.9	1.8	6.9	6.0
Egypt	0.1	0.0	0.0	1.4	1.9	0.2	0.6	2.6	2.5
Equatorial Guinea	0.0	2.6	0.0	0.8	0.7	0.5	1.8	1.5	0.4
Ethiopia	0.1	0.1	0.8	0.0	0.1	1.6	0.0	0.0	0.4
Gabon	0.0	0.5	0.5	0.0	0.1	0.0	1.1	0.4	0.8
Ghana	0.9	0.1	0.0	0.0	1.1	0.2	0.0	0.0	0.4
Kenya	0.9	0.7	0.6	0.0	0.0	1.1	0.0	2.7	0.7
Madagascar	...	...	...	...	...	...	...	...	2.9
Mali	1.4	2.3	0.9	1.7	1.4	0.1	1.3	0.0	0.2
Mauritius	0.0	0.1	0.0	0.0	0.0	0.0	0.0	1.0	0.1
Morocco	0.9	0.6	0.6	0.0	2.1	0.0	0.9	1.0	3.0
Mozambique	0.1	0.0	0.0	0.0	0.7	1.5	0.7	0.1	0.1
Namibia	0.0	0.4	0.0	0.0	0.0	1.1	0.0	0.5	0.0
Niger	...	...	...	...	...	...	...	...	0.0
Nigeria	1.1	1.8	6.6	3.4	0.3	0.0	0.9	0.6	1.2
Rwanda	...	...	...	...	...	...	...	...	0.6
South Africa	3.1	2.3	0.8	2.0	0.9	2.2	0.9	0.5	0.6
Tanzania	0.2	0.1	0.1	1.6	0.0	1.6	0.7	0.0	0.5
Tunisia	1.4	0.7	0.1	2.8	0.7	1.8	3.0	0.7	0.0
Uganda	0.0	0.4	0.4	0.6	0.7	0.1	0.4	0.9	0.6
Zambia	1.4	0.0	1.7	0.7	0.0	1.2	1.3	1.6	0.5
Zimbabwe	0.1	0.1	0.0	0.2	1.2	0.6	1.5	2.5	0.5

Note: See note on methodology.
Source: Authors' calculations based on *Marchés Tropicaux et Méditerranéens.*

Table 23 - Hardening of the Regime

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Algeria	11.9	6.5	4.3	2.5	0.3	8.1	15.0	4.5	8.9
Angola	...	...	...	...	...	...	...	...	5.7
Benin	...	...	...	...	...	...	...	...	1.2
Botswana	0.3	0.5	0.0	0.6	0.0	0.0	0.0	0.0	1.0
Burkina Faso	0.8	1.9	0.6	4.5	1.6	1.1	2.7	2.4	2.8
Cameroon	7.4	5.9	1.9	1.6	1.0	3.3	0.9	2.2	2.5
Chad	2.9	1.0	1.4	0.0	1.1	2.6	1.7	0.0	0.9
Congo	...	...	...	...	...	...	...	...	1.4
Congo, Dem. Rep.	...	...	...	...	...	...	...	...	4.9
Côte d'Ivoire	2.9	2.5	0.7	10.2	7.8	1.4	3.2	7.2	9.6
Egypt	9.4	6.8	5.5	2.0	7.7	3.9	11.5	4.8	4.0
Equatorial Guinea	0.0	1.2	5.0	0.0	0.0	0.9	5.7	0.5	8.1
Ethiopia	7.5	3.9	2.4	0.0	0.7	3.6	8.4	1.2	1.3
Gabon	1.0	5.1	0.7	2.1	0.4	0.0	0.5	1.3	3.6
Ghana	2.2	0.8	2.5	2.4	0.0	0.8	1.3	0.0	0.4
Kenya	3.9	11.0	3.6	0.0	0.0	0.7	1.2	2.0	2.3
Madagascar	...	...	...	...	...	...	...	...	2.8
Mali	0.4	5.1	0.0	0.4	1.2	1.1	0.3	1.0	0.3
Mauritius	0.3	0.0	0.0	0.4	0.0	0.0	0.0	2.2	0.4
Morocco	5.0	3.7	1.4	1.2	3.4	2.9	2.5	3.7	5.6
Mozambique	0.3	0.9	2.3	1.1	3.7	1.2	0.0	0.4	1.6
Namibia	0.0	0.3	0.0	1.2	1.6	0.3	0.3	0.8	0.3
Niger	...	...	...	...	...	...	...	...	1.6
Nigeria	125.5	9.1	5.8	4.2	4.5	2.8	2.4	3.5	12.4
Rwanda	...	...	...	...	...	...	...	...	4.0
Senegal	1.7	3.3	2.7	0.3	0.0	1.7	1.1	1.4	0.9
South Africa	18.6	14.3	6.1	4.5	1.9	1.2	1.8	1.7	4.0
Tanzania	1.3	0.4	0.5	0.0	0.3	0.4	0.0	0.5	0.0
Tunisia	3.9	1.5	1.5	2.4	1.4	3.3	2.9	1.6	6.4
Uganda	3.1	0.0	0.7	0.9	0.0	5.8	1.3	3.8	12.3
Zambia	5.5	8.5	3.9	3.0	1.1	4.7	5.2	1.5	2.4
Zimbabwe	4.0	3.7	7.7	5.1	4.8	12.5	17.5	15.5	16.3

Note: See note on methodology.

Source: Authors' calculations based on *Marchés Tropicaux et Méditerranéens*.